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U.S.-JAPAN ECONOMIC RELATIONS YEARBOOK 1984-1985

Table of Contents

Part I: Introduction

1

Part II: The International Setting

3

World Economic Developments 3
Industrial Countries; Developing Countries

International Interactions 6
Trade and Payments; Exchange Rates; New MTN Round

U.S. Economic Developments 8
Growth; Monetary Policy; Fiscal Policy

U.S. Trade and Payments 11
Balance of Payments; Trade

U.S. Trade Policy 14
Policy Debate; Major Legislative Actions

Part III: The Japanese Economy

19

Economic Overview 19
Growth; Monetary Policy; Fiscal Policy; Balance of Payments; Trade

Domestic Economic Policy 30
Financial Liberalization; Tax Reform; Privatization and Deregulation; Structural Reform; Protection of Intellectual Property

International Economic Policy 42
Market Access Packages; Exchange Rates; Foreign Direct Investment

Part IV: Political and Security Developments

Political Developments 51 — 51
Coalition Politics; Second Term; Third-Term Maneuvering

Legislative Issues 55
1983-84 Diet Actions; 1984-85 Diet Actions; Nakasone's Popularity

Security Issues 57
One-Percent Debate; Five-Year Plan; Defense Cooperation; FSX; Congressional Input

Foreign Aid 59

Part V: U.S.-Japan Economic Relations

Overview 61 — 61
Rethinking Strategy; Japan's Response

Access to Japan's Markets 63
Financial Markets; MOSS Talks; NTT Procurement Pact; Beef and Citrus; Other Agricultural Issues; Tobacco Products; Leather and Leather Products; Legal Services

Access to U.S. Markets 86
Semiconductors; Cars; Steel; Machine Tools; Textiles and Apparel; Aviation; Fishing; Whaling; Unitary Tax

Part VI: U.S.-Japan Trade and Direct Investment

Trade 103 — 103
U.S. Exports to Japan; U.S. Imports from Japan

Direct Investment 110
United States in Japan; Japan in the United States; Update of JEI Manufacturing Survey

Appendices

Chronology 115 — 115

Statistical Tables 135

Part I

Introduction

Japan and the United States witnessed major transformations in 1984 and 1985, both in their relationships with one another and in their respective positions in the global economy. Certainly the most publicized changes were the explosive growth of the U.S. trade deficit at a time when Japan was chalking up ever bigger surpluses and the clash these twin developments caused between Capitol Hill and the executive branch over U.S. trade policy. With the flood of red ink exerting an increasing drag on the U.S. economy's performance after mid-1984, congressional critics of the Reagan administration's hands-off approach to the ballooning trade deficit put the White House on notice that if it did not "do something," Congress would.

While the deficit grew with nearly all of this country's major trading partners, American rhetoric if not official U.S. actions toward Japan was especially sharp due to the magnitude of its trade surplus with the United States and the world. Japan's overall trade surplus more than doubled between 1983 and 1985 to $46.1 billion, with four-fifths of this jump attributable to the widening gap between exports to the United States and imports from its top supplier. Ironically, exports played a smaller role in the economy's expansion during the mid-1980s than they did earlier in the decade, although this did not stop critics from constantly referring to Japan's export-led growth.

U.S. criticism of Japanese trade policies and practices was intensified by an underlying American worry that Japan might displace the United States as the world's leading economy or at least overtake it in high technology and other areas that had long been the domain of American companies. Japan's increasing world market share for such products as semiconductors represented one aspect of this challenge. The transformation of the United States from the world's largest creditor nation to the unenviable status of the world's largest debtor at the same time that Japan was becoming the leading creditor nation illustrated another key part of the shift in the fortunes and international influence of the two countries.

The alternatives for U.S. action on the trade front were varied, but their potential impact and practicality were dubious. Legislated protection was popular among certain congressional and interest group coalitions, but frequently was abandoned as unworkable. More generic approaches, such as the reform of basic U.S. trade laws, also had their moments in the spotlight, but failed to be enacted into law. In the end, though, the political pressures became too severe for the remaining "free traders" to remain unaffected by the growing debate over the U.S. role in world trade and the future of the American economy in light of growing foreign — especially Japanese — economic inroads.

The administration responded to the call for action to deal with the ballooning bilateral trade deficit by initiating a new concept in bilateral negotiations — market-oriented, sector-selective talks — at the start of 1985. Patterned after 1984's successful financial liberalization discussions, the so-called

MOSS talks were designed to improve market opportunities in Japan for highly competitive American products. Government officials hoped that progress in the first four sectors selected — telecommunications equipment and services, sophisticated electronics, medical equipment and pharmaceuticals, and forest products — would both relieve some of the immediate political pressure in Washington while securing greater access to Japanese markets.

A second focus of attack centered on economic fundamentals. Even many congressional pressure groups began to admit during the mid-1980s that many of the trade problems facing U.S. businesses had little to do with the allegedly closed markets of Japan and other countries or the unfair trading practices of their exporters. More important were the strong dollar and faster growth in the United States than in most other economies, which made this country a magnet for foreign exporters while curtailing U.S. shipments abroad; the Third World debt crisis also dampened overseas demand for American-made products. The high value of the dollar reflected this country's huge federal budget deficit, which forced the United States to rely on capital inflows to cover its financing requirements.

One result of the rising protectionist pressure and the growing focus on economic fundamentals was the September 1985 agreement among the five leading industrial nations to lower the value of the dollar. This move came too late in the year to have any immediate impact on trade flows. But along with a tougher White House stance toward foreign barriers to U.S. exports, it helped take some of the political heat in Washington off Japan. It also took the steam out of several protectionist trade bills in Congress. The administration was therefore able to maintain a generally free-trade posture, although at times it did pressure other countries to adopt "voluntary" restraints on their U.S.-bound exports.

Japan responded to the drumbeat of criticism from Washington by taking several steps to defuse tensions. A series of market access packages promised significant changes in the openness of the Japanese economy for both goods and services, while Japan's financial liberalization moves resulted in greater integration between Japanese and international capital markets. The fact that administration officials negotiated many of the terms and even the details of these measures indicated the intimacy — as well as the contentiousness — of the U.S.-Japan policy dialogue.

The long-term perspectives taken by the prime minister's special commissions on the Japanese economy indicated a recognition of Japan's new role in the international economy. The studies sometimes were criticized by Japan's trading partners as lacking specifics, but they nevertheless contributed to a growing debate in Japan on the importance of basic economic transformations to assure continued access to overseas markets and preserve sound political relationships.

In political terms, the October 1985 re-election of Prime Minister Yasuhiro Nakasone as president of the ruling Liberal Democratic Party dominated the domestic scene. Mr. Nakasone continued his pattern of taking a higher profile in the international arena than was the Japanese custom. An integral element of his efforts was management of the economic and political relationship with the United States, a task helped by the 1984 re-election of President Ronald Reagan, with whom Mr. Nakasone had developed a close relationship.

Like their American counterparts, Japanese government officials pursued a dual strategy, although with somewhat different emphasis. Japan's approach was designed to implement gradual reforms on the international front while assuring continued economic growth at home led by domestic demand. In addition to the market opening packages, the cabinet continued its policy of tight budgets while emphasizing administrative reform — a program to spin off quasi-government corporations into self-sustaining private entities.

The combination of these developments in the United States and Japan produced a situation in which economic issues frequently precipitated tensions between the two countries, yet most officials in both governments agreed that political and security relationships were in better shape than ever. Japan's importance to the United States was recognized in word and deed by the U.S. government, while Japanese officials continued to move cautiously but clearly toward assuming responsibilities in the international arena commensurate with the country's economic prowess. For example, U.S.-Japan security cooperation expanded, and Japanese spending on defense increased steadily during the two years in real terms despite tight overall budgets.

Thus the 1984-85 period saw increasing interdependence between Japan and the United States, with the former becoming steadily more dependent on the American market and the latter increasingly reliant on Japanese capital. This yearbook attempts to portray the key aspects of the accelerating pace of bilateral relations, which are of great importance not only to the two countries but to the globe as a whole.

* * *

This publication is the seventh in the series. As in the case of its predecessors, it would not have been possible without the financial support and special funding of Japan's Ministry of Foreign Affairs. We gratefully acknowledge the contributions that have made the series possible over the years.

Part II

The International Setting

Mixed. That one word summed up world economic trends in 1984 and 1985. The global economy completed its second and third years of recovery from the high inflation rates and deep recession following the second oil shock in 1979. According to the International Monetary Fund, world gross national product grew at an inflation-adjusted 4.4 percent rate in 1984, the highest since 1978, and international trade continued to rebound from its 1982 contraction. In contrast, the world economy turned in a disappointing performance in 1985; the expansion unexpectedly slowed, with real GNP up just 3.1 percent, and trade increased at only a fraction of its year-earlier rate.

One notable characteristic of the expansion was a marked deceleration of inflation rates — a strong contrast to the high or accelerating inflation that accompanied previous recoveries. Interest rates also declined significantly. Growth resumed in some major developing debtor countries in 1984, helping to avoid a serious debt crisis. A more activist U.S. approach resulted in progress toward international cooperation in several areas, including exchange rates and the debt problems of developing countries. Japan, meanwhile, took new measures to liberalize its trade and financial systems.

But serious problems threatened the stability of the global economy during the 1984-85 period. The misalignment of exchange rates resulted in large trade and financial imbalances that gave rise to protectionist pressures, particularly in the United States. Increasingly, countries resorted to export subsidies and bilateral agreements limiting imports to resolve trade problems. The strong dollar pushed the U.S. trade deficit to historic peaks and helped make the United States a net debtor to the rest of the world for the first time since World War I. Japan, whose ballooning current account surpluses made it the largest creditor nation at the end of 1985, came under increasingly sharp attack from its trading partners.

To make matters worse, many regions did not share fully in the economic recovery. Western Europe's sluggish growth was insufficient to reduce its unemployment rate from double-digit levels. The 1985 slowdown in growth in industrial countries aggravated Latin America's debt problems, which remained a barrier to that region's long-term development and a threat to its political stability. Moreover, much of Africa experienced continued economic deterioration marked by a tragic famine.

World Economic Developments

Industrial Countries

The United States, Japan and Canada led the global recovery from the 1981-82 recession, one of the deepest since the depression of the 1930s. The U.S. expansion, made possible by the successful anti-inflation program initiated by the Federal Reserve Board in November 1979, was encouraged by stimulative fiscal and monetary policies. But the large federal budget deficits, which helped the economy grow by an

inflation-adjusted 6.4 percent in 1984, were the prime cause of the high interest rates that fueled the dollar's appreciation. The yawning trade deficit that resulted in significant measure from the strong dollar was the major reason for sluggish growth beginning in mid-1984. The diversion of domestic demand to imports helped lower real growth to 2.7 percent in 1985.

The expansion in Japan, which began in March 1983, was encouraged by favorable developments in the economies of its major trading partners, particularly the United States. A big jump in total exports lifted 1984's growth rate to an inflation-adjusted 5.1 percent, the highest since 1978. The expansion lost some steam in 1985, in large part because of the slowdown in the United States, but real GNP was still up by 4.5 percent. Much of the credit for this fairly strong showing went to business investment, which climbed at a double-digit rate for the second straight year and provided the spark that was missing in other sectors of the economy. The public sector, in fact, was a drag on growth — graphic proof of Tokyo's continued commitment to fiscal austerity, while consumer spending again increased at a rate that was modest at best.

European economies also took advantage of the U.S. expansion. Still, Europe failed to keep pace with the recovery in the United States and Japan, with real GNP increasing by only 2.6 percent in 1984 and 2.4 percent in 1985. The causes of these mediocre results were numerous and certainly not new. Two stood out, though: Europe's failure to create a true common market, which impeded market efficiency and economies of scale, and the large subsidies paid to agriculture and declining industries — payments that diverted resources from more productive uses.

Despite the 1984-85 economic expansion, unemployment remained a serious problem, with nearly 31 million idle workers in the 24 countries belonging to the Organization for Economic Cooperation and Development. Aggravated by a heavy influx of younger workers, the unemployment rate in Europe rose to 11 percent in 1985. The continent's failure to create enough new jobs was not simply the result of slower growth; it also reflected the inflexibility of European wages, itself the product of aggressive unions and wage indexation. In addition, high non-wage labor costs and labor immobility helped keep unemployment rates high. The U.S. economy was more successful at creating jobs, although the 7.2 percent unemployment rate at the end of 1985 was high by historical standards. Japan's jobless rate remained relatively low, although it did hit a postwar record high of 2.9 percent in December 1985.

Despite generally high unemployment rates, a majority of industrialized countries cut budget deficits and restrained money supply growth during the 1984-85 period. Government deficits as a share of GNP in the OECD countries fell from 4.3 percent in 1983 to 3.6 percent in 1985 despite the failure of the United States to significantly reduce its budget imbalance. The austere fiscal policies, combined with declining commodity prices, resulted in a further slowdown in inflation. Consumer prices in industrialized countries increased by just 4.1 percent in 1985, the fifth year of reduced inflation, and there was a notable narrowing in the divergence of inflation across countries. With consumer price increases in the 2 percent range in both 1984 and 1985 Japan and West Germany had the lowest inflation rates.

A rise in interest rates in early 1984 threatened the economic recovery and magnified the debt burden of developing countries. Europe and Japan became increasingly critical of the huge U.S. budget deficit, which, by raising interest rates, forced them to maintain higher rates than they would otherwise choose. But a variety of factors, including Federal Reserve policies and confidence that inflation would remain low, led to a 3.5 percentage point drop in the U.S. prime rate during the 18 months following its June 1984 peak of 13 percent. Nevertheless, interest rates, both nominal and real, in industrialized countries remained high by historical standards.

Developing Countries

Economic developments in the Third World during the 1984-85 period were closely linked to international trade trends. According to IMF statistics, developing country exports rose 6.7 percent in 1984 before falling back by 3.7 percent in 1985. The 1984 rise, largely a result of a big jump in U.S. imports from these suppliers, fueled a 4.1 percent expansion in aggregate real output. The U.S. slowdown in 1985, though, contributed to an unexpected 0.9 percentage point drop in the average growth rate of developing countries.

There was a wide regional divergence in the economic performance of developing countries. As a group, Asian countries continued to experience the most rapid growth — 6 to 8 percent in inflation-adjusted terms, led by dramatic economic changes in China. The spread of reforms from agriculture to urban areas unleashed market forces there that helped produce growth estimated at 12 percent in both years. For Asia's newly industrialized countries (Korea, Taiwan and Hong Kong), though, 1985 was a disappointment as the small rise in U.S. purchases that year throttled their export-oriented economies and sliced the growth rate from 9.4 percent in 1984 to 3.5 percent. Moreover, the expansion in ASEAN (Association of Southeast Asian Nations) countries, which depend heavily on commodity exports, was brought to a near standstill in 1985 by falling prices for such industrial raw materials as tin, rubber and oil.

After a decade of lavish earnings, falling oil prices and export volumes gave Middle Eastern countries a taste of austerity. In 1981 Saudi Arabia, Kuwait and the United Arab Emirates together earned almost $150 billion from their oil exports; by 1985 that figure had shrunk to only $45 billion. Despite sharp cuts in imports, Saudi Arabia's net foreign assets shrank from $150 billion in 1982 to $90 billion at the end of last year. The austerity resulting from declining export earnings made the Middle East the only region to experience negative growth in 1985.

Growth of World Output

percent change in real terms

Area	1981	1982	1983	1984	1985
World	1.6%	0.5%	2.6%	4.4%	3.1%
Industrial Countries	1.4	-0.4	2.6	4.8	3.0
United States	1.9	-2.5	3.6	6.4	2.7
Other Industrial Countries	1.1	0.8	2.0	3.6	3.2
Japan	3.7	3.1	3.2	5.1	4.6
West Germany	n.a.	-1.0	1.5	3.3	2.5
Developing Countries	2.2	1.6	1.4	4.1	3.2
Africa	1.8	0.8	-1.7	1.7	2.0
Asia	5.5	5.0	7.6	7.9	6.0
Europe	2.3	2.3	1.1	3.5	2.2
Middle East	-1.8	-0.1	0.1	0.9	-1.2
Western Hemisphere	0.9	-1.0	-3.1	3.2	3.7
Fuel Exporters	0.9	-0.2	2.0	1.4	0.1
Non-fuel Exporters	2.8	2.5	3.1	5.5	4.8
Market Borrowers	2.2	0.4	-1.0	3.5	2.9
Official Borrowers	3.3	2.1	1.7	3.2	1.8
U.S.S.R. and Eastern Europe	1.9	2.8	4.2	3.6	3.2

Source: International Monetary Fund

Countries in Latin America and Africa pursued a strategy aimed at re-establishing international creditworthiness and restoring the momentum of domestic growth. After an economic contraction in 1982 and again the next year, Western Hemisphere developing countries bounced back in 1984 and 1985 with real growth in the 3 percent range. So did Africa, although the turnaround was more modest. Still, per capita incomes in much of Latin America and Africa remained substantially below 1980 levels and some of the poorest countries could not even meet relatively minor obligations to the IMF and World Bank.

The Third World debt problem, which began in August 1982 when Mexico was unable to service its foreign debt, remained a worrisome problem in the mid-1980s and continued to pose a threat to the stability of the international banking system. According to the World Bank, developing country debt totaled $950 billion at the end of 1985. Debtor nations paid about $22 billion more to banks and other lenders that year than they received in new loans despite the rescheduling of $93 billion of the debt.

The expansion of international trade in 1984 helped take the debt crisis off the front pages. With a sharp rise in exports, the combined current account deficit of the 15 most heavily indebted nations (which included 10 countries in Latin America and three in Africa) fell to $11 billion compared to a 1982 peak of $50.6 billion. Together with the decline in interest rates in the United States and other lending countries, debt service costs fell to 29 percent of export earnings from 30.7 percent in 1982. The drop in world oil prices was also beneficial, although it obviously hurt exporters such as Mexico and Venezuela. These factors helped raise the total official reserves of the 15 countries from $26.3 billion in 1982 to $39.6 billion. Other positive trends included the increasing share of official debt and long term debt in the total amount owed by the group.

There was less progress on the debt issue in 1985 as overseas sales by the 15 major debtor countries fell 3.3 percent; however, this drop was partially offset by a decline in imports for the fourth consecutive year. Nevertheless, financial institutions remained reluctant to extend new loans, with the result that net external borrowing from non-official sources fell from $5 billion in 1984 to a minus $14 billion the following year. Brazil, the world's largest debtor at the end of 1985, was one bright spot. The new government's anti-inflation campaign helped slow the country's triple-digit inflation while maintaining 8 percent real growth.

Other developing countries' economic policies were less successful. Measures by Argentina's new president to control hyperinflation, which soared to a 1,300 percent annual rate in 1984, plunged the economy into a recession in 1985. Following its 1984 recovery from a sharp recession, Mexico's economy stumbled the next year as a result of the falling price of oil — the source of roughly two-thirds of the country's export revenues.

While IMF adjustment programs helped avoid a major default in either 1984 or 1985, Third World debtors grew increasingly weary of austerity and antagonistic toward the Fund. Peru's new president arbitrarily limited interest payments to 10 percent of export earnings and stopped interest payments on an IMF loan. Brazil went even further, refusing to deal with the IMF on the grounds that the belt-tightening measures it demanded would be destabilizing.

Faced with the worsening situation of many debtor countries, U.S. Treasury Secretary James Baker proposed a

new approach to ease the debt crisis at the October 1985 IMF/World Bank meetings in Seoul, Korea — an approach that emphasized adjustment via growth rather than continued belt-tightening. The "Baker Plan" called for a $9 billion increase in World Bank lending to problem debtors, accompanied by a $20 billion increase in lending by commercial banks. It also urged debtor countries to adopt market-oriented structural reforms to encourage growth. This initiative marked a major policy shift for the administration of Ronald Reagan, which had viewed the debt problem as an issue between borrowing countries and their commercial bank lenders. Realizing the need for additional capital to promote growth in debtor countries, Washington decided to push a more active role for governments and international financial institutions. At the same time, though, the "Baker Plan" was motivated by the depressing effect of the debt crisis on U.S. exports.

Policies to encourage price stability are one of the most important changes required in debtor countries. By discouraging saving and promoting capital flight, the rapid inflation in many Latin American countries has increased their reliance on foreign capital. Despite progress in several countries, the average inflation rate in Western Hemisphere developing countries rose to 145.7 percent in 1985. For developing countries as a group, though, more cautious monetary policies helped reduce the median inflation rate to 8.7 percent that year. Asia, in addition to being the fastest-growing region, had the lowest average inflation rate — 7.4 percent.

International Interactions

Economic relations among nations in 1984 and 1985 were troubled by the persistent debt problems of many developing countries and large trade imbalances that left the major international organizations struggling against spreading protectionism. A report in early 1986 identified 120 voluntary export restraint or market-sharing arrangements worldwide that were inconsistent with the General Agreement on Tariffs and Trade's rules covering international trade. But the decline of the dollar in 1985 after four years of steady appreciation provided hope for multilateral cooperation in stabilizing exchange rates and reducing international imbalances. Moreover, the liberalization of domestic capital markets encouraged internationalization and made capital flows a powerful force in the world economy.

Trade and Payments

Merchandise Trade According to GATT, the volume of world merchandise exports rose 3 percent in 1985, only one-third of 1984's increase. The slowdown reflected scaled-back economic growth in the United States, Europe and Japan and a contraction in imports by heavily indebted developing countries. Manufactured exports accounted for 1985's increased volume; in fact, exports of agricultural and mineral commodities declined. Based on a parallel set of IMF statistics, the value of trade in dollar terms increased only 1.2 percent in 1985 — a marked change from 1984's 6.6 percent expansion. This marginal growth, moreover, was accompanied by reduced trade between industrialized and developing countries.

Trade patterns were characterized by historically large imbalances. Export-led growth in Japan and West Germany resulted in big surpluses equivalent in 1985 to 4.2 percent and 4.7 percent of GNP, respectively. With shipments to developing countries flat, the United States accounted for much of the rise in other industrialized countries' exports during the 1984-85 period. As a result, the U.S. trade deficit rose to 3.3 percent of GNP, creating fears that the country was in the process of being deindustrialized.

Although Third World exports were hardly any higher in 1985 than two years before, the regional distribution was different. Asian exports rose substantially, while overseas sales by Latin America and Africa posted just slight gains. These increases, however, were offset by a sharp drop in Middle Eastern exports — a drop that reflected declines in both the volume and value of oil shipments. Members of the Organization of Petroleum Exporting Countries, in fact, experienced current account deficits in both 1984 and 1985 in sharp contrast to 1980's $95 billion surplus.

Capital Flows Economists once argued that under a floating exchange rate system, currency values would adjust to balance trade between countries. Instead, international capital flows have become the driving force in foreign exchange markets. The importance of these flows is illustrated by the fact that trade in goods and services — about $2.5 trillion in 1985 — accounted for well under 10 percent of the estimated $35 trillion in foreign exchange transactions that took place that year in major financial centers.

Not surprisingly, Japan, with its high saving rate and large trade surplus, was the largest net exporter of capital in both 1984 and 1985, supplying $49.7 billion and $64.5 billion, respectively. Net purchases of securities, which were concentrated in U.S. Treasury bonds, represented three-fourths of the total. Japan also accounted for about two-thirds of the increase in global foreign direct investment in 1984, the last year for which data are available, although its share of the total stock was still only 6.9 percent — far below this country's 42.5 percent and Britain's 15.5 percent.

As a result of its ballooning trade surplus, Japan's net assets soared from $37.3 billion at the end of 1983 to $129.8 billion two years later. The surge enabled Japan to leapfrog Britain and West Germany as the world's top creditor nation. In the wake of its huge 1985 trade deficit, the United States became a debtor nation for the first time since World War I with net liabilities of $107.4 billion. The investment income that flows from the divergent international financial positions of Japan and the United States will become increasingly important in the future, adding to both Japan's current account surplus and the U.S. deficit.

Exchange Rates

Despite one record-breaking U.S. trade deficit after another in the first half of the 1980s, the dollar soared 56 percent on a trade-weighted basis against the currencies of major trading partners from July 1980 to its peak in February 1985. The dollar's appreciation was partly the result of the divergence between fiscal policy in the United States and other industrialized countries. While Japan and most European countries cut their government deficits, this country's federal deficit rose from 2.3 percent of GNP in 1980 to 4.9 percent in 1984. With U.S. capital spending staging a strong comeback in the second half of 1983 and then picking up more momentum in 1984, domestic saving was insufficient to meet both private and public demand for capital. The outcome was predictable: a run-up in U.S. interest rates. So was the next phase in the process, as the interest rate differential between the United States and other countries pulled in capital from around the globe and drove up the dollar's value. Most studies show that the strong dollar accounted for over half of the increase in the U.S. trade deficit during the 1981-85 period.

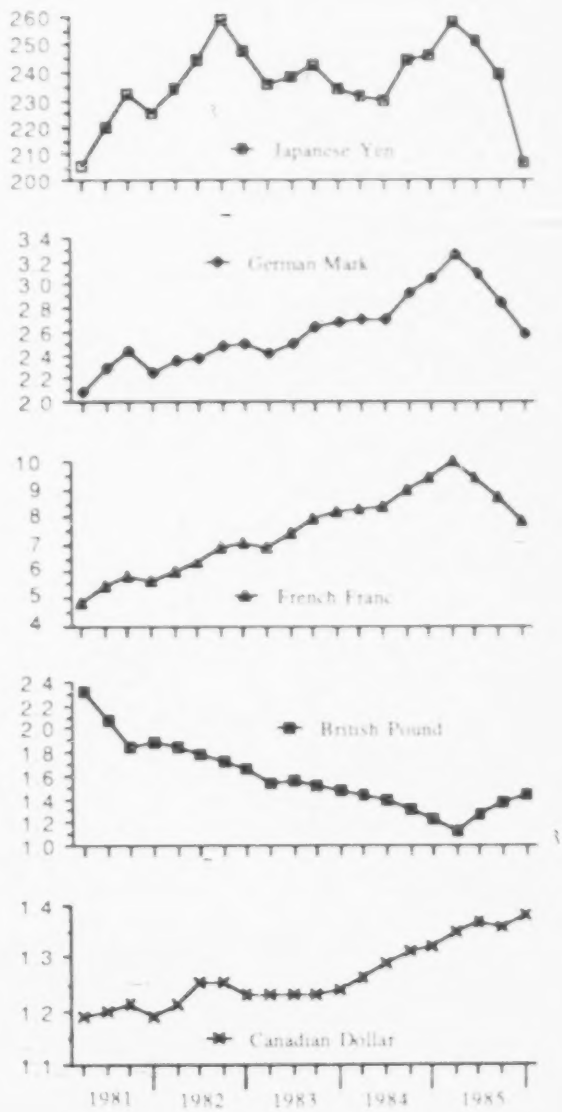
After reaching a peak in late February 1985, the dollar began to decline for several reasons. Passage of the Gramm-Rudman-Hollings bill, which mandated cuts in the budget deficit, signaled a reduction in U.S. capital requirements. There was also some indication that foreign investors had become nervous about continuing to make large net investments in the United States — perhaps because of this country's new status as a net debtor nation. For 1985 as a whole, the dollar declined 12.3 percent on a trade-weighted basis.

The dollar's decline accelerated after the Group of Five meeting in New York City on September 22, 1985. Officials from the United States, Japan, France, West Germany and Britain agreed to launch a coordinated effort to correct their large external imbalances and defuse growing protectionist sentiment in the United States. Noting that the dollar's value did not reflect economic fundamentals, the group pledged to take measures, including market intervention, to reduce its value.

This agreement marked a significant policy shift for the Reagan administration, which had previously viewed the strong dollar as a reflection of U.S. economic strength rather than a problem. Accordingly, it had generally refrained from intervention in exchange markets. But strong protectionist pressures in Congress convinced Washington and its allies that measures to drive down the dollar were necessary. The

Exchange Rates

units per dollar, except British pound



psychological impact of this agreement reinforced the dollar's downward trend. From September 22 until the end of 1985, the dollar fell about 20 percent against the yen.

New MTN Round

With protectionism gaining momentum around the world during 1984 and 1985, the Reagan administration pressed hard for international agreement on a new round of multilateral trade negotiations under the GATT to first shore up the threatened free-trade system and then expand it. While Tokyo joined Washington in pushing for another set of global trade talks as soon as possible, European Community support was lukewarm at best. At the May 1984 OECD ministerial meeting and again at the June 1984 London summit meeting of the leaders of the world's seven major industrial nations, EC representatives were willing to support a new MTN round in principle, but they balked at setting a specific target date for the start of negotiations.

Against this backdrop, representatives of GATT's 90 member countries held their annual meeting in November 1984. One of Washington's major objectives going into the meeting was to forge a consensus that services, which account for about one-fourth of global trade, should be included in the multilateral trade regime. This initiative ran into immediate and stiff opposition from developing country members worried that their fledgling banking, insurance and other service industries would be overrun by businesses from the United States, Europe and Japan. A compromise was finally hammered out, but it fell far short of Washington's goal. The members simply agreed to have the GATT conduct an analysis of global trade in services while putting off for a year formal discussion of whether the multilateral trade forum should incorporate services into the regime.

France threw up another roadblock to a new MTN round at the April 1985 OECD ministerial meeting, insisting that negotiations to reform the international monetary system must accompany trade talks. Although Washington agreed to consider hosting a conference on this subject — a major concession from an administration committed to the floating exchange rate system, European representatives still resisted pressure from the United States and Japan to commit themselves to a starting date for a new MTN round.

France's odd-man-out position was highlighted the following month at the seven-nation Bonn economic summit. Although West Germany, Britain, Italy and Canada joined the United States and Japan in agreeing that the new round should start in 1986 and that a "balanced package" should be the basis of the negotiations, French intransigence blocked unanimous approval of a firm starting date. But French footdragging was not the only problem. Continued opposition by Brazil, India, Argentina, Yugoslavia and Egypt to the inclusion of services on the new round's agenda prevented a July 1985 GATT conference from agreeing to begin preparations for the trade talks.

Its patience worn thin, the United States requested a special GATT meeting for October. Through threat — putting other countries on notice that it was prepared to abandon GATT's tradition of agreement by consensus and demand a vote on major issues — and compromise — shelving the question of whether to include services in the multilateral trade regime for the time being, Washington finally managed to orchestrate a decision to proceed with preparations for international trade negotiations. The first step down this road was taken at the annual GATT ministerial meeting in November when the organization's member countries agreed to convene a preparatory committee to plan the agenda for the eighth MTN round.

While savoring this victory, American trade policymakers knew their hardest work lay ahead. For starters, the controversial issue of whether the upcoming trade negotiations would cover services was left hanging at the November meeting. Moreover, the European Community and the United States were at loggerheads over another of Washington's primary objectives for the new round — negotiations to reduce barriers to trade in agricultural commodities.

U.S. Economic Developments

The U.S. economy caught forecasters off-guard in 1984 by turning in a stronger-than-expected performance, but it also took them by surprise in 1985 when growth came in well below most initial projections. Inflation remained low by recent standards and, unlike previous expansions, showed no signs of accelerating. Unemployment, though, was stuck at recession-like levels despite a substantial increase in jobs. Fiscal policy continued to be expansionary, and all sectors of the economy except net exports contributed to the expansion. The pervasive decline in the U.S. trade balance, however, exerted an increasing drag on growth. After more than four years of appreciation, the substantial decline in the dollar's value during 1985 raised hopes for an improvement in the trade balance in the near future.

Growth

The surprising strength that characterized the economy's 1983 rally from the deep 1981-82 recession was even more in evidence in 1984 when inflation-adjusted GNP, already up by 3.6 percent, climbed by another 6.4 percent. The Reagan administration's self-congratulation was cut short, though, by

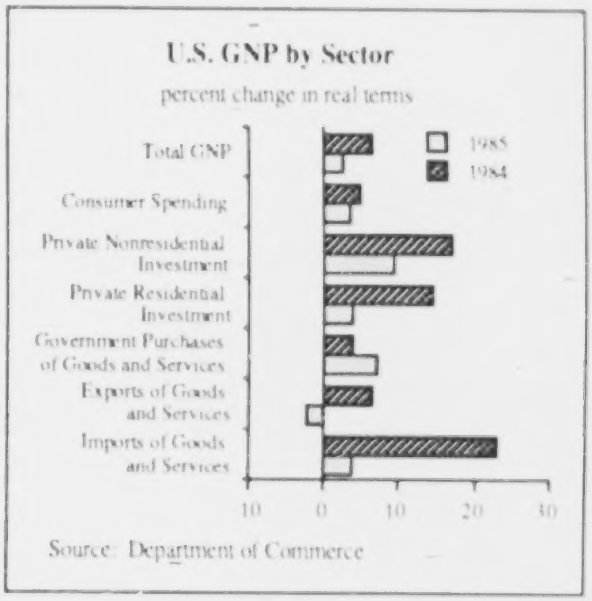
the emergence of a disquieting trend: the expansion steadily lost steam in 1984, with real growth dropping from a robust 9.8 percent at an annual rate in the year's opening quarter to a weak 1.5 percent in the last three months. As it turned out, this slowdown was just a preview of worse to come. Inflation-adjusted GNP expanded by a disappointing 2.7 percent in 1985, not only because the recovery was winding up its third year but also because the economy's performance became erratic. Growth came in at a respectable 3.1 percent in the January-March period and 4.1 percent in the July-September period, but in the second and fourth quarters it unexpectedly slid to 2.3 percent and 2.1 percent, respectively.

Demographic patterns and a decline in inflation that restored real incomes insured that consumer spending, which had propelled the economy out of recession in 1983, would keep the expansion rolling even if other sectors flagged. Advancing by 4.7 percent in real terms in 1984, personal consumption — the source of roughly two-thirds of GNP — provided a backup engine to the booming growth of capital spending and housing construction. In 1985, when these two sectors returned to more normal expansion paths, it became the economy's driving force, increasing by 3.5 percent.

Regardless of the consumer's role in the continued upturn, most of the increase in spending was earmarked for durables, particularly cars and trucks. Purchases of nondurables were relatively weak in both 1984 and 1985, while expenditures for services, which account for half of consumer outlays, were up by margins in the mid-3 percent range. But there was a down side for the economy from strong consumer demand: personal saving as a share of disposable income, already below the 8 percent averaged during the 1970s, declined from 6.3 percent in 1984 to 5.1 percent the following year.

Just as consumers were taking a breather in 1984, business investment kicked in, expanding by an awesome 16.9 percent in real terms, as American manufacturers belatedly recognized the need to invest in more productive plant and equipment to strengthen their international competitive position. Another jump in residential construction and a big inventory buildup in 1984 also gave the expansion a shot in the arm. By the end of 1985, however, the investment boom had generally run its course. Capital spending was up for the year but by a margin indicative of a maturing expansion — 9.3 percent. Housing construction likewise increased at a more moderate pace. But the main sign that the expansion's rapid growth phase was over was an enormous liquidation of business inventories.

All the talk in Washington and state capitals in the mid-1980s about the need to rein in government expenditures turned out to be just that — talk: government spending increased by an inflation-adjusted 6.8 percent in 1985 on top of a 4 percent rise the year before. Federal purchases of goods and services provided much of the boost, led somewhat surprisingly in 1985 by a big jump in spending on non-defense programs. But state and local governments, which outspent the federal government by anywhere from a third to a fourth in the first half of the 1980s, also kept outlays rising on a modest growth curve.



The slower expansion of consumer spending and private investment in 1985 highlighted the recovery's major weak spot: the external sector. The surge in the inflation-adjusted U.S. trade deficit from $19.9 billion in the first year of the rebound to $83.6 billion in 1984 knocked 2 percentage points off that year's real growth rate, but this fact passed largely unnoticed since the economy's 6.4 percent expansion was robust by historical standards. By 1985, when imports of goods and services topped exports by $108.2 billion in real terms, the drag of a ballooning trade deficit on the economy's performance could no longer be ignored: it meant the difference between respectable growth for an economy then in its third year of expansion — 3.4 percent — and a so-so real increase of 2.7 percent.

Although the snowballing trade deficit held down growth, the U.S. economy outdistanced Japan's in 1984 for the second straight year. But the 1985 slowdown was less severe in Japan, which grew 60 percent faster than this country. The biggest difference between the two countries, though, was the sectoral pattern of the expansion, with the United States relying on domestic demand and Japan getting a boost

from foreign demand. Consumer spending, which led the U.S. recovery, was sluggish in Japan. Moreover, the substantial increase in U.S. government spending stood in sharp contrast to Japan, where in real terms the government spent less in 1985 than in 1983. The expansions in the two countries did share one characteristic — a big gain in capital spending.

Monetary Policy

With the economy's recovery, the Federal Reserve replaced the expansionary monetary policy in place from 1982 to mid-1983 with a more restrictive stance during 1984. Motivated by the need to foster economic growth and the success in lowering inflation, monetary policy actions in 1985 were generally accommodative, as money growth accelerated, interest rates fell and the dollar depreciated.

The M1 measure of the money supply (currency plus demand deposits and other checkable deposits) increased just 6.3 percent between December 1983 and December 1984, well within the Fed's 4 to 8 percent target range and significantly below 1983's 9.9 percent advance. In 1985, however, M1 consistently overshot the 8 percent upper bound of its target band, jumping by 12.2 percent on a December-to-December basis. Yet the Fed made no attempt to bring M1 back within range, in part due to a marked decline in velocity but also because other measures of the money supply remained within the limits set by the central bank. Moreover, the Fed, recognizing that the uncertainties surrounding the dollar and the economy's performance demanded greater flexibility than usual in policy implementation, looked beyond the behavior of monetary aggregates to such indicators as output, the movement of the dollar in foreign exchange markets, inflation and conditions in domestic and international credit markets in assessing whether more or less restraint was needed in 1985.

The Fed's restrictive monetary policy in 1984 forced interest rates up in the first half of the year, aggravating the debt problems of developing countries and encouraging capital inflows that further strengthened the dollar. The prime rate moved up from 11 percent in January to 13 percent during the summer before easing in 1984's final quarter, while six-month Treasury securities went from 9 percent-plus to around 10.6 percent before returning to the 8 to 9 percent range.

The Fed's cautiously accommodative policy in 1985, including a three-step cut in the official discount rate from the 9 percent in effect from April through November 1984 to 7.5 percent in May, encouraged a decline in interest rates. The prime fell to 9.5 percent after mid-year from 10 percent-plus in the first half, while six-month Treasury securities fell to the low 7 percent range. Prospects of smaller government budget deficits eased fears of inflation and encouraged an even larger decline in long-term rates. The rate on 10-year government securities, for example, fell from 13.6 percent in June 1984 to 9.3 percent at the end of 1985.

Unlike the accelerating increase in the U.S. money supply over the 1984-85 period, Japan's central bank kept money growth within a relatively narrow, moderate range. But this restraint was not by choice: high real interest rates in the United States dictated that the Bank of Japan pursue a tighter monetary policy than warranted by domestic economic conditions to limit capital outflows that would further lower the already weak yen.

With inflation running about 4 percent in the United States during 1984, real long-term interest rates were in the 8 to 10 percent range. In Japan, where the inflation rate was hovering around 2 percent, real long-term interest rates were in the 5 percent range, presenting a substantial incentive to invest in this country. To avoid widening the differential, the Bank of Japan maintained its discount rate at 5 percent through 1984 and 1985. The fall in U.S. long-term rates over the course of 1985, though, had nearly eliminated the U.S.-Japan interest rate gap by year-end.

Fiscal Policy

U.S. fiscal policy remained markedly expansionary in the mid-1980s, although the federal budget deficit did fall from a then-record $195.4 billion in FY 1983 (October 1982-September 1983) to $175.3 billion in FY 1984 as rapid economic growth swelled government revenues. But 1985's showdown and a significant rise in outlays led to a new all-time-high deficit of $211.9 billion in FY 1985. Expenditures, which climbed by 12.4 percent after a FY 1984 increase of 5.8 percent, hit $945.9 billion in the year through September 1985, returning the share of government spending in nominal GNP to FY 1983's 24 percent level. On the other side of the ledger, revenues rose 10.1 percent on top of FY 1984's 11 percent gain and reached $734 billion — an increase that lifted the ratio of government receipts to current-price GNP from 18.1 percent in both FY 1983 and FY 1984 to 18.6 percent in the October 1984-September 1985 period.

Although the FY 1985 budget deficit broke all records, it actually represented a smaller proportion of nominal GNP — 5.4 percent — than FY 1983's shortfall (5.9 percent). This fact did nothing to relieve pressure on Capitol Hill and in the White House for limits on the growth of government spending, viewed at both ends of Pennsylvania Avenue as the principal cause of the escalating deficit. Congressional frustration finally found an outlet in the December 1985 passage of the Gramm-Rudman-Hollings Act, which mandated step-by-step elimination of the federal deficit by FY

1991. Many legal experts, though, questioned the constitutionality of the law.

Ironically, the Reagan administration's policy of reducing the budget deficit without raising taxes was more successfully implemented in Japan. In line with its goal of ending deficit financing by FY 1990, Tokyo continued on a course of fiscal austerity in the mid-1980s, holding the increase in government spending to 1.3 percent in FY 1984 and 3.3 percent in FY 1985 despite fast-rising debt servicing costs.

Japan's progress in trimming its budget deficit had an unintended side effect: it added to the country's supply of surplus saving. Just as the share of business investment in GNP began to fall following the 1973 oil shock, the government started to run large deficits that absorbed the private sector's savings. The reduction in the deficit after 1980, however, created a substantial surplus of saving that in turn led to increasingly big capital outflows and matching current account surpluses.

The United States faced the opposite problem: private-sector savings were insufficient to fund both capital spending and the federal budget deficit. High real interest rates therefore attracted enormous capital inflows, offset by equally large current account deficits. The mismatch of fiscal policies in the two countries, in short, produced huge external imbalances.

U.S. Trade and Payments

The United States ran a merchandise trade surplus every year after World War II until 1970. Between its last surplus in 1975 and 1982, the trade deficit zigzagged up but remained within politically acceptable bounds, in part because the traditional U.S. surplus in services trade kept the current account fairly close to balance. All that changed with the 1983 recovery. The trade deficit seemed to take on a life of its own in the mid-1980s, the services trade surplus waned, the current account plunged ever deeper into the red and the country became increasingly dependent on the inflow of foreign capital.

Balance of Payments

Merchandise Trade The U.S. merchandise trade deficit on a balance of payments basis nearly doubled in 1984 to a once-unimaginable $112.5 billion after doing the exact same thing the year before. And that was not the end of the bad news. The hemorrhage of red ink actually increased in 1985 to $124.4 billion, as imports expanded by $6.4 billion on top of 1984's incredible $63.5 billion surge and exports, which had rallied in 1984, slipped back $5.5 billion.

The seemingly nonstop deterioration of the U.S. trade balance was the product of a long list of factors — the overvalued dollar, faster economic growth in the United States than in most other industrialized countries, particularly in 1984, the Third World debt crisis and the crimp on the earnings of Middle East oil exporters. Moreover, the anticipated beneficial impact of the dollar's depreciation in 1985 was not felt as the trade imbalance set one quarterly record after another starting in the April-June period. In fact, the decline of the dollar swelled the dollar value of U.S. imports, with the effect on volume yet to materialize.

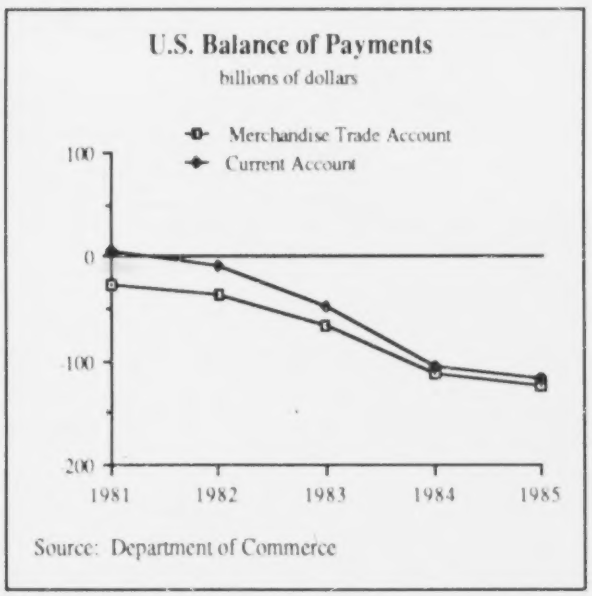
Services The decline in the U.S. surplus in services trade, which fell from $30 billion in 1983 to $18.2 billion in 1984, also had multiple causes. First, net investment income contracted $6.1 billion to $18.8 billion, reflecting the reduction in this country's net external assets following three years of increasingly bigger current account deficits. This decline reflected a $2.6 billion drop in net income on foreign direct investment and a $3.5 billion decline in net income on portfolio investment that occurred despite a rise in U.S. receipts in both categories. Second, the strong dollar hurt the U.S. competitive position in other business services. The deficit on net travel and passenger fares, for example, rose $3 billion to $7.6 billion in 1984.

While the declining dollar did not prevent another record-breaking merchandise trade deficit in 1985, it did help lift net services receipts to $21.8 billion. A doubling in net income on direct investment due to currency gains from the dollar's fall raised net investment income to $25.2 billion. This gain came despite a swing in net income on portfolio investment from a $6.5 billion surplus in 1984 to a $1.1 billion deficit.

Current Account As a mature creditor nation, the United States in the past was able to rely on income from overseas investment to offset the merchandise trade deficit. In 1981, for example, net investment income of $34.1 billion exceeded the $28 billion merchandise trade deficit, yielding a small current account surplus. But that was the last year this country was in the black. After 1981 it was simply a question of how much red ink would flood the current account each year. The deficit, which had skyrocketed in 1983 to $46.6 billion, more than doubled the next year to $106.5 billion and then moved up to $117.7 billion in 1985.

Capital Flows and Overall Balance Since a current account deficit must be matched by a capital inflow, the huge deficits rung up in the mid-1980s signified that the United States had become a major importer of capital. From $35.5 billion in 1983, the net U.S. capital inflow swelled first to $79.1 billion and then to $94.7 billion in 1985. (Statistical discrepancies of $27.3 billion and $23 billion, respectively, accounted for the failure of these numbers to equal the current

account deficits. Economists believe the discrepancies are mainly short-term capital flows undetected by the government.) The jump in the net capital inflow in 1984 was largely the result of a $26.4 billion drop in capital outflows. In 1985, however, the flow of money out of the United States increased but was more than offset by a $24.3 billion expansion in capital inflows to $127.1 billion.



The enormous jump in the net inflow of capital into the United States in 1984 was due to three developments. First, foreign lending by U.S. banks, which had taken a nosedive in 1983 in the wake of the Third World debt crisis, fell by an additional $18.8 billion to only $11.1 billion as financial institutions reduced their exposure in developing countries having difficulty servicing their debts. Second, foreign purchases of U.S. securities doubled to $35.8 billion, with Treasury securities accounting for about two-thirds of the total. Third, foreign direct investment in the United States also doubled, reaching $25.4 billion.

The net U.S. capital inflow climbed again in 1985 due in large part to another doubling in foreign purchases of U.S. securities to $71.4 billion. This time around, acquisitions of corporate securities accounted for the increase as purchases of Treasury securities declined slightly. This expanded inflow, however, was partially offset by a quadrupling in U.S. direct investment abroad to $18.8 billion. With the strong dollar making it difficult for domestic companies to fend off foreign competitors, many American manufacturers moved part of their production overseas to strengthen their hand.

With a net long-term capital outflow of $49.7 billion in 1984 and $64.5 billion in 1985, Japan was the major supplier of capital to the United States. In fact, three years of huge current account surpluses made Japan the world's biggest net creditor nation at the end of 1985 with net external assets of $129.8 billion. At the same time, the United States, which had net external liabilities of $107.4 billion, became the largest debtor nation, replacing Brazil and Mexico. While the U.S. foreign debt as a share of GNP was much smaller than that of the Latin American countries, this country's deep indebtedness to the rest of the world had important implications for its external balance in the years to come.

Trade

The export and import numbers released monthly by the Department of Commerce painted the same picture of a rapidly deteriorating U.S. trade performance as the balance of payments data did. The only difference was that there was even more red ink — $123.3 billion in 1984 and $148.5 billion in 1985, in large part because imports are valued on a higher cost, insurance and freight basis. Yet the precise size of the deficit really made no difference in the fight between Capitol Hill and the White House over this country's trade policy. Whatever the number, it was just more political grist for senators and representatives already convinced that the U.S. trade deficit was out of control and that Congress had to do something in the absence of action by the Reagan administration.

The trade figures clearly put the White House on the defensive. Still, administration trade policymakers could find a thin silver lining in the numbers, particularly for 1985. Exports did slip 2.2 percent that year to $213.2 billion after rallying 8.9 percent in 1984 from a two-year decline, but this drop was surprisingly small considering the impact of the high-flying dollar on the price competitiveness of U.S. suppliers overseas, the generally so-so economic performance turned in by other industrialized nations, the debt problems of many developing countries, and the scaled-back revenues of oil exporters. Likewise, while imports expanded 6 percent in 1985 to $361.6 billion, this gain was modest — whether compared with the 26.4 percent jump in purchases that occurred in 1984 or in terms of the slowdown in U.S. growth — since the overvalued dollar gave foreign competitors a big edge in the American market.

Needless to say, arguments linking the snowballing U.S. trade deficit to the sluggish state of the world economy and the strength of the dollar fell on deaf ears on Capitol Hill since this line of reasoning defied the conventional wisdom that unfair trade practices by this country's major trading partners were a key cause of the flood of red ink. Nor could supporters of protectionism look objectively at Japan's role

in the seemingly nonstop erosion of the U.S. trade account; blaming Japan for the whole problem was simply too convenient.

The U.S. trade deficit with Japan did soar from $21.7 billion in 1983 to $49.8 billion in 1985, but this surge represented only one-third-plus of the $79.1 billion jump in the overall red-ink entry. Worsening trade results with the European Community and Canada were responsible for another third of this country's fast-expanding trade imbalance, as 1983's $1.6 billion deficit with the 10-member Common Market swelled to a $22.5 billion shortfall in 1985 and the traditional deficit with Canada slid $7.9 billion further into the hole to $22.2 billion.

Almost equally important was the $15.7 billion deterioration in the U.S. trade position with developing countries, which shipped $51.4 billion more here in 1985 than they bought — up from a gap of $35.7 billion two years before. Interestingly, the Asian NICs, not oil exporters, were the source of this extra red ink. The combined deficit with Korea, Taiwan and Hong Kong climbed by $10.6 billion between 1983 and 1985 to $24 billion, while the imbalance with oil-exporting countries declined by nearly $2.5 billion to $19.2 billion.

Perhaps nothing better highlighted the across-the-board deterioration in the U.S. trade account than two interrelated facts: this country had surpluses with only four of its 20 largest trading partners in 1985 — the Netherlands, Saudi Arabia, Australia and Belgium-Luxembourg — and the U.S. position worsened with all but three of these 20 countries (Australia and oil exporters Mexico and Indonesia being the exceptions) between 1983 and 1985. In 1985 the United States ran the biggest deficits with Japan ($49.8 billion), Canada ($22.2 billion), Taiwan ($13.1 billion) and West Germany ($12.2 billion).

This picture of a worsening bottom line in trade with almost all key American trading partners had its counterpart in the U.S. trade performance on a product basis. Surpluses in capital goods and agricultural commodities big enough to cover chronic deficits in industrial supplies, automotive products and consumer goods were a thing of the past long before the mid-1980s. By that time the only question was whether trade in capital goods and farm products would remain in the black. The answer — "just barely" — provided additional ammunition for congressmen determined to find a legislative solution to this country's trade problems.

American manufacturers of capital goods from high technology products on down were caught in a double bind in the mid-1980s. The strong dollar capped the expansion of exports well below what might have been expected for a period of international economic recovery, even allowing for the weakness of the rebound in some major markets and the improved technological and manufacturing capabilities of other suppliers. At the same time, foreign rivals, capitalizing on their enhanced price and product competitiveness, siphoned off a significant part — perhaps as much as two-fifths — of the booming domestic demand for machinery. In one product group after another, therefore, the United States saw its traditionally large trade surplus shrink or even disappear between 1983 and 1985.

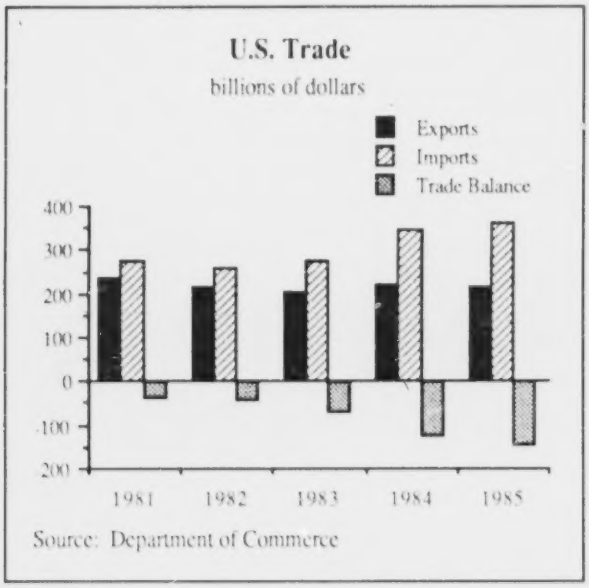
Unlike capital goods, this country's dwindling surplus in agricultural commodities was two parts lower exports and one part higher imports. There was another difference as well: the strong dollar took a backseat in the drop of overseas farm sales to sluggish world food and feed demand, expanded output in importing countries and stiff competition from traditional foreign exporters and newcomers alike. In reality, even these factors were secondary causes of the export slide. The main problem was domestic farm policy, which kept U.S. agricultural prices above international levels in the buyers' market of the mid-1980s.

While Congress zeroed in on the evaporating surpluses in capital goods and agricultural commodities as symptomatic of the shortcomings of the administration's trade policy, the widening gap in the three other end-use categories did not escape notice, particularly the expanding deficit in automotive products. The reason this category attracted attention was obvious: protectionist-minded legislators thought they could pin the blame for a big part of the erosion in the U.S. trade account on Japan. What they discovered instead was that fast-expanding imports from Japan generated less of the extra red ink in U.S. trade in automotive products than the combination of much bigger purchases from both Canada and the European Community.

Congressmen anxious to make Japan the scapegoat for this country's worsening trade results moved even farther off target when they tried to link Japan alone with the bulging deficit in consumer goods — the category that accounted for the largest share of the jump in the overall U.S. trade imbalance. Rapidly increasing deliveries from Japan certainly figured in the ballooning deficit in consumer goods, but they were much less of a factor than soaring imports from Taiwan, Korea, Hong Kong and other Asian suppliers.

Ironically, the product category that was the primary cause of the U.S. trade deficit in the late 1970s and early 1980s — industrial supplies — played the smallest role in the enormous run-up of the imbalance during the mid-1980s. The major credit for this development went to oil imports, which, at $51.5 billion in 1985, were 5.3 percent lower than in 1983, in part due to a reduced volume of crude purchases but mainly because of falling world prices. At the same time, though, exports of industrial supplies held up better than

might have been expected, thanks in large part to expanded shipments of chemicals.



Source: Department of Commerce

U.S. Trade Policy

Despite the fact that the U.S. trade deficit almost doubled in 1983 and again the next year to enormous proportions, trade policy did not become a high-profile political issue until 1985. Admittedly, some import-restrictive measures did make their way through both the Senate and the House of Representatives in 1984, but the economy's strong performance generally kept protectionist forces at bay.

That changed in 1985 as the economy began to sputter and the drag of the ballooning trade deficit on growth became more obvious. Pressure for congressional action to defend American trade interests intensified, fueled by the spreading conviction among Democrats and Republicans alike that the executive branch was not prepared to get tough with U.S. trading partners. By late summer passage of some form of protectionist legislation seemed likely.

This prospect finally forced the White House to go on the offensive. In a major trade policy initiative announced in September, President Reagan unveiled a strategy of eliminating overseas barriers to U.S. exports and combating unfair foreign trade practices. The administration's new activism on the trade front together with its decision to orchestrate a fall in the dollar's value temporarily checked the drive on Capitol Hill for protectionist legislation. In the end only one import-restrictive bill was passed, although many were still pending as 1985 came to a close.

Policy Debate

The deluge of red ink in the U.S. trade account transformed trade policy into a major political issue in the mid-1980s, but the process was surprisingly slow considering the long list of industries caught between stiff import competition and shrinking export markets. Until late in the summer of 1984, this squeeze did little more than generate increasingly frequent calls for import restrictions from congressmen who had always championed sector-specific protection. Their next step — building a strong bipartisan consensus on the need for remedial legislation and translating this support into action — proved more difficult, even though 1984 was an election year.

Several constraints operated on Congress. There was an awareness that the U.S. budget deficit and the strong dollar were just as much causes of the trade deficit as unfair trade practices. There was also the fear that blatantly protectionist legislation could lead to foreign retaliation and ignite a trade war. Other factors came into play as well — for example, differences among legislators over what industries to protect and a desire for early adjournment in order to campaign for re-election.

Election-year pressures finally gave the drive for trade legislation momentum. In the days leading up to adjournment in early October, first the Senate and then the House passed a comprehensive package of trade measures. Both packages contained provisions the Reagan administration considered to be high priority — extension of the Generalized System of Preferences, authority to negotiate a free-trade agreement with Israel, and the reciprocity bill sponsored by Sen. John Danforth (R, Mo.), which was designed to enhance the ability of the president to negotiate the reduction of foreign nontariff barriers to U.S. exports (see below). But they also included some sectoral measures unacceptable to the White House, particularly those providing protection for the steel and wine industries, as well as objectionable elements of trade remedies.

The omnibus trade bill that emerged from the conference committee was less protectionist than the legislation originally passed by the Senate and the House; in fact, it was almost free of overtly protectionist language. This outcome was partly a by-product of the robust performance of the economy, but the White House shared the credit. Thanks to the lobbying prowess of U.S. Trade Representative William Brock, the conferees stripped the bill of its most import-restrictive provisions and watered down other measures

unacceptable to the president while retaining the initiatives sought by the administration.

Ironically, Congress could afford to take the high road on trade legislation in an election year because Mr. Reagan, in a retreat from his free-trade ideology, had already taken the low road on the politically charged question of relief for the steel industry. In mid-September the president announced that steel imports would be rolled back for five years through the negotiation of restraint arrangements with major suppliers. The goal of this program — an 18.5 percent market share for foreign steel — was close enough to the 17 percent target in the House bill for congressional supporters of steel industry protection to declare victory.

Tokyo also had an indirect hand in the generally free-trade content of the omnibus trade bill. If nothing else, it helped keep domestic content legislation in limbo by extending restraints on Japan's U.S.-bound car shipments for a fourth year starting in April 1984 and maintaining the export ceiling at the April 1983-March 1984 level. At the same time, progress on several market access issues of interest to Washington gave the administration some ammunition to counter congressional calls for retaliation against Japan.

While the White House managed to contain the political fallout from the trade deficit in 1984 with a big assist from the economy and a smaller one from Japan and some other key trading partners, it became clear soon after the 99th Congress convened that the administration would have a hard time duplicating this success in 1985. For starters, the economy was no longer an ally since its faltering performance highlighted the rising cost of the huge trade imbalance in terms of lost output and jobs. Then came the president's early March decision not to ask Tokyo for a fifth year of limits on car exports and Japan's subsequent announcement that the restraints would be retained but the cap raised by nearly 25 percent. These twin events drew congressional attention to the trade issue like no other developments had in the previous two years and led one legislator after another to wonder aloud whether the White House really had a trade policy.

Some tough talk in the spring from trade officials frustrated by the slow progress Washington was making in negotiations with Japan on improved market opportunities for American exporters of telecommunications equipment and other competitive products did little to convince congressmen, whether Democrat or Republican, that the administration had a strategy for dealing with this country's trade problems. On the contrary, the perception that the White House was floundering spread, in large part because of the spring resignations of the top U.S. trade policymaker, USTR Brock, and a key negotiator, Under Secretary of Commerce for International Trade Lionel Olmer, and the delay in appointing replacements.

A variety of developments during the summer insured that trade policy would remain a hot topic on Capitol Hill. Democrats became more firmly convinced that they could gain political mileage from the trade issue after their victory in a special House election in Texas in which the effect of imports on employment was a major subject of debate. A bill introduced in July by Rep. Dan Rostenkowski (D, Ill.), Rep. Richard Gephardt (D, Mo.) and Sen. Lloyd Bentsen (D, Tex.) to impose a 25 percent import surcharge on countries like Japan that run big trade surpluses with the United States attracted additional attention to trade topics, although support for the initiative evaporated as its drastic economic side effects were publicized. Finally, congressmen from both parties were angered by the president's August rejection of an International Trade Commission recommendation of quotas on shoe imports.

Nothing better captured congressional frustration with the White House's management of U.S. trade problems than the fact that more than 100 protectionist bills were on the Hill calendar at the beginning of September. These bills were not just for show. Passage of at least one import-restrictive piece of legislation — most likely a measure requiring drastic cutbacks in textile and apparel imports — and possibly a few others seemed a safe bet.

These odds finally forced the White House to go on the offensive. On September 23 President Reagan unveiled a strategy of "free and fair trade," featuring a program to combat unfair foreign trade practices and a commitment to take the lead in the movement toward a new round of multilateral trade negotiations under the GATT. Foreign trade practices that damage American interests will no longer be tolerated, the chief executive said in a speech directed equally at congressional critics of his trade policy and at U.S. trading partners. He spelled out a plan to enforce trade statutes more aggressively and to set up an interagency "strike force" to pinpoint unfair trade practices and develop ways to eliminate them. Mr. Reagan also announced that Washington was prepared to match subsidized export credit offers made by U.S. competitors in third markets in an effort to force other governments to end the practice of mixing aid funds and loans at commercial or OECD rates.

In concluding the first statement of his administration's overall trade policy since early 1981, the president expressed a willingness to work with Congress to enact legislation promoting free and fair trade. He did not present a specific legislative agenda, opting instead to outline areas of possible executive-congressional cooperation. These included negotiating authority for a new round of international trade talks, improved protection of intellectual property rights,

stronger antidumping and countervailing-duty laws, and shorter deadlines as well as a fast-track procedure for trade dispute settlements.

The White House had actually previewed its new get-tough position on unfair foreign trade practices in early September when it took the unprecedented step of self-initiating three investigations under Section 301 of the 1974 Trade Act. Singled out for maintaining restrictions that block market access for specific American products or services were Brazil (policies for the promotion of its data processing industry), Korea (ban on foreign life insurance operations) and Japan (restrictions on sales of foreign cigarettes). At the same time, the president set a December 1 deadline for resolution of two long-running unfair trade practices cases involving Japan (import quotas on leather and leather footwear) and the European Community (subsidies to canned fruit producers) — another step never before taken by Washington.

These actions were not one-shot moves. In mid-October the administration announced that it was self-initiating a 301 investigation of Korea's lack of protection for intellectual property rights and filing a complaint against EC wheat export subsidies under the GATT's subsidies code. Then in early December the president, endorsing the first recommendation of the trade "strike force," gave the Department of Commerce the green light to start an antidumping investigation of current-generation memory integrated circuits imported from Japan — another precedent-setting action.

These demonstrations of a White House on the offensive persuaded many initially skeptical legislators that the administration was in fact prepared to stand up for American interests. More than anything, though, the five-nation agreement orchestrated by Treasury Secretary Baker to lower the dollar's sky-high value — reached the day before Mr. Reagan unveiled the new U.S. trade strategy — helped to slow the momentum for protectionist legislation. There was enough residual frustration with U.S. trade policy in both the House and the Senate to insure passage of the textile-apparel bill, but the fact that no other piece of import-restrictive legislation cleared either chamber in 1985 was proof that the executive branch had wrested control of the trade issue from Congress — at least for the time being.

Major Legislative Actions

Trade and Tariff Act of 1984 Signed into law by President Reagan on October 30, 1984, this legislation was the first major trade bill passed by Congress since 1979. The act renewed until mid-1993 the Generalized System of Preferences program, which eliminates tariffs on eligible imports from qualifying developing countries. At the same time, though, it established stricter criteria for participation and mandated the elimination of GSP benefits for countries above specified per-capita income levels.

The omnibus trade law also addressed two other items on the White House's legislative agenda. First, it granted the president authority to negotiate a free-trade agreement with Israel and provided for expedited congressional consideration of this and other free-trade arrangements. Second, what were referred to as the "reciprocity" provisions of the act gave the chief executive authority to negotiate reductions in barriers to U.S. exports of services and to foreign direct investment and to work out agreements affecting trade in high technology products. The legislation also amended the 1974 Trade Act to allow the U.S. Trade Representative to self-initiate unfair trade practices investigations under Section 301.

In addition, the 1984 law made several modifications to this country's antidumping and countervailing-duty statutes, such as establishing a procedure to handle persistent dumping and expanding the definition of a subsidy. Expanded as well was the list of criteria the International Trade Commission must consider in deciding under Section 201 of the 1974 Trade Act whether increasing imports caused serious injury to an American industry. The act also set forth a new method of congressional disapproval of presidential decisions on 201 cases.

Export Administration Act One of the most contentious issues facing Congress during the 1984-85 period was the extension of the Export Administration Act, the regulations that control exports of sensitive technology to other countries. Caught between the conflicting needs to preserve national security while not unduly restricting U.S. exports of high technology products, Congress failed to approve a new EAA during the 98th Congress, which ended in 1984. The major stumbling block was disagreement between the House and the Senate on the role of the Department of Defense in limiting sensitive exports. Another sticking point was whether the Customs Service or the Department of Commerce should be responsible for enforcement. As a result of this impasse, the president was forced to rely on emergency powers to control exports after the measure expired in March 1984.

With strong administration support and a determination to avoid the controversies that stalled action in 1984, the EAA bill was handled expeditiously in the 99th Congress. The new act, approved by both chambers in late June 1985, excised provisions to expand the powers of the Secretary of Defense to control exports for national security reasons, leaving the Pentagon's control over high technology shipments to Soviet bloc countries basically unchanged. This represented a limited concession to the business

community, which had argued that government interference had cost it a large number of export orders.

Other important provisions included tougher penalties for violators and limits on the president's power to impose embargoes against foreign countries. The extended act also substantially eased export licensing regulations for businesses dealing with Western Europe and Japan; exempted agricultural products and low technology products, such as personal computers, from most existing controls; and expanded congressional oversight functions.

Textile and Apparel Trade Enforcement Act of 1985 Of the 100-plus import-restrictive bills introduced in Congress in 1985, the so-called "Jenkins Bill" was the only protectionist measure passed by both chambers. Sponsored in the House by Rep. Ed Jenkins (D, Ga.) and in the Senate by South Carolina Sens. Strom Thurmond (R) and Ernest Hollings (D), the bill initially enjoyed the backing of over two-thirds of each chamber. Its provisions required drastic cutbacks in all textile and apparel imports except those from Canada and the European Community, but the bill's main targets were the Big Four suppliers — Taiwan, Hong Kong, Korea and China.

Eventually, provisions to restrict footwear imports and to aid the copper industry were added to consolidate backing for the bill. Despite these additions and a watered-down textile-apparel import provision, support for such industry-specific action began to waver by the time of final passage. In the end the bill was approved in both chambers with less than the two-thirds majorities required to override a presidential veto.

In vetoing the bill December 17, President Reagan declared that "the economic and human costs of such a bill run far too high — costs in foreign retaliation against U.S. exports, loss of American jobs, losses to American businesses and damage to the world trading system on which our prosperity depends." Supporters of the bill set an override attempt for August 1986, close to the mid-term elections. One of their stated goals was to encourage U.S. negotiators to take a hard-line approach during talks on a new Multi-Fiber Arrangement, due to expire July 31, 1986.

Telecommunications Trade Act of 1985 Legislation threatening sanctions in an effort to open foreign markets to American-made telecommunications products was introduced in both chambers during 1985. The prominence of the bills was linked to ongoing bilateral negotiations to open Japan's soon-to-be-deregulated domestic telecommunications market to foreign equipment and services. For this reason the measures even garnered tentative White House approval since the actions relied primarily on existing trade remedies and seemed consistent with GATT provisions.

Although the telecommunications measure was held up in the House by the Ways and Means Committee's preoccupation with tax reform, the Senate Finance Committee approved it in September. At that point the generic wording of the measure became more overtly directed at Japan, and support for floor action mounted. A last-minute plan to bring the bill to the Senate floor before adjournment in December was thwarted, however, by Sen. Hollings, angry over the treatment his textile-apparel bill had received in the Finance Committee.

Unfair Trade Practices of Japan Act of 1985 This bill was a binding form of the resolution condemning Japan that passed both chambers around the time Tokyo announced that restraints on U.S.-bound car exports would be extended beyond March 31 but at a higher level. The legislation required the president to announce within 45 days the actions he intended to take to retaliate against unfair Japanese trade practices and to implement those actions within 90 days. At a minimum, it would force the president to "offset the effect on the merchandise trade balance of the relaxation of Japanese restraints on the exportation of automobiles to the United States."

The measure passed the Senate Finance Committee with bipartisan support in April. But a plan to bring it as well as the telecommunications bill to a vote on the floor of the Senate right before the December adjournment was blocked by Sen. Hollings, who attached his textile-apparel bill to both measures. This move made some accommodation by the Senate leadership necessary before either bill could be considered.

Trade Reform Packages One of the most significant legislative developments in 1985 was the compilation of a variety of omnibus trade reform bills on both sides of Capitol Hill. As the allure of product- and country-specific protectionist measures dimmed, an increasing number of legislators came to the conclusion that general trade reform represented a more constructive response to this country's multiplying trade problems. Some of these measures attempted to formulate a more comprehensive trade policy as well as implement an ambitious restructuring of the trade management bureaucracy. Also included, though, were a variety of import-restrictive measures that would inhibit trade. With the House busy on tax reform and the Senate's energies unfocused, 1985 saw the beginning of the process of consolidation toward a major trade reform push in 1986.

Part III

The Japanese Economy

Having completed its adjustment to the 1979 oil crisis and subsequent slowdown, the Japanese economy was at a crossroads as 1985 came to a close. The preferred route — moderate but sustained growth led by domestic demand — had many hurdles. The biggest was the continued weak showing of consumer spending and the soft housing market. With business investment, the mainstay of growth in the 1984-85 period, expected to lose some momentum and the government's policy of fiscal austerity eliminating the public sector as a source of stimulus, a means of spurring personal consumption and residential investment became even more of a necessity.

Another major obstacle to moderate, sustained growth was, paradoxically, the performance of the external sector. Foreign demand was responsible for an estimated one-third of growth in 1984 and 1985 if the indirect impact of capital spending by export-oriented manufacturers is added to the direct effect of the trade surplus. But this source of stimulus was endangered by the steep appreciation of the yen in the wake of the September 22, 1985 decision of the Group of Five nations to lower the value of the dollar. The volume of exports was predicted to contract, at least in the short run, after increasing in 1985 at a much slower rate than the year before. At the same time, the volume of imports, which had expanded by a fairly significant margin in 1984 and then marked time in 1985, was projected to go up.

The stronger yen, while reining in economic growth, was unlikely to mute the foreign criticism triggered in the 1984-85 period by Japan's ballooning trade surplus since both the J-curve effect and the ongoing fall in international oil prices would further swell the dollar-denominated figure. This criticism produced a steady stream of market access initiatives from Tokyo designed to improve business opportunities in Japan for overseas suppliers of goods and services. These measures covered not only the usual list of tariff cuts and reductions in nontariff barriers but also liberalization of Japan's financial system — a process with far-reaching international and domestic implications. Included as well was the deregulation of the Japanese market for telecommunications equipment and services, although this development, like the changes introduced in the market for cigarettes, was the product of the administrative reform movement.

Economic Overview

The 1984-85 period was a time of intensifying debate over Japanese economic policies — both within and among the government, the ruling party and the business community and between Tokyo and its major trading partners. The economy's unbalanced performance during these two years raised questions about the appropriateness of monetary and fiscal policies and what the government could and should do to stimulate lagging sectors of domestic demand. Similarly, the huge trade surpluses chalked up in 1984 and 1985 led to a continuing discussion in Japan about how to respond to increasing foreign pressure for policy

changes extending across the trade, monetary and budget fronts.

Growth

Japan's economy weathered the deep 1981-82 global recession in much better shape than its American counterpart. For that reason alone, the Japanese recovery lacked the drama of the U.S. rebound. Still, the economic tempo clearly changed in 1984. Inflation-adjusted gross national product, which had continued to idle in the low 3 percent growth range in 1983, expanded by 5.1 percent — its best showing since 1979. Moreover, just as in the United States, the strength of 1984's rally caught Economic Planning Agency analysts and business forecasters alike off-guard since their initial projections were clustered around 4 percent real growth.

Anxious to avoid international criticism that the world's second-largest economy was not making a big enough contribution to the global recovery, Japanese policymakers were buoyed by the economy's stronger-than-expected performance. There was also relief that domestic demand provided the main engine of growth, not the net external sector, which generated only about one-fourth of the 5.1 percent gain in output compared with nearly half of 1983's real increase.

Yet there were some worrisome aspects to the pattern of domestic growth. Consumer spending did not give the same kick to the Japanese expansion that it did in the United States despite any number of favorable developments. In addition, residential construction, again defying government predictions of a turnaround, declined for the sixth straight year. With public-sector expenditures providing no stimulus, the strength of domestic demand was largely a function of bullish plant and equipment investment and a big inventory buildup.

Capital spending remained the economy's driving force in 1985, with net foreign demand, which contributed just over one-fifth of the rise in inflation-adjusted GNP, the main backup engine. On the other hand, stock building did not give the same boost to the economy that it did the year before, and personal consumption continued to muddle along as consumers again refused to take full advantage of another gain in real disposable income. To make matters worse, the government sector actually was a drag on the economy's performance. But there was one piece of good news on the economic front: residential construction finally expanded. This turnaround, though, was too modest to offset the weakness in consumer spending and government purchases of goods and services, and real growth wound up at 4.5 percent in 1985 — 0.6 percentage point less than 1984's result.

The slowdown came as no surprise. Both government economists and private forecasters had predicted this result, in part because the Japanese economy was moving from the recovery phase to the expansion stage in 1985; in addition, the world economy was completing its third year of adjustment to the problems of the early 1980s. Growth also lost momentum in the United States, they pointed out. In fact, Japan outperformed this country for the first time in three years.

But Tokyo did have cause for concern about the economy's behavior in 1985. To begin with, imports of goods and services barely rose in real terms, leaving Japan open to the international criticism it had partly avoided in 1984. More importantly, the economy's performance became so erratic from one quarter to the next that Japanese policymakers would have gladly traded places with their American counterparts. Inflation-adjusted growth tumbled in both 1985's opening quarter (1.7 percent) and the July-September period (2.7 percent) only to rebound strongly in each succeeding quarter (5.7 percent and 5.8 percent, respectively) in response to the vagaries of net foreign demand. This roller-coaster ride reinforced the obvious: without a strong, across-the-board expansion in domestic demand, the Japanese economy was headed down an increasingly bumpy road.

Domestic Demand Restrained consumer spending, which increased by just 2.7 percent in real terms in 1985 after rising by an equally weak 2.8 percent the year before, was the primary obstacle to a more robust domestic expansion, simply because personal consumption expenditures are the source of well over half of Japan's GNP. What puzzled economists about the behavior of consumers was that consumer fundamentals were generally better in the mid-1980s than in 1982 and 1983 when inflation-adjusted outlays advanced by bigger margins.

At the top of the list of indicators pointing to a pickup in consumer spending was the accelerating growth of personal income. Continuing modest gains in total employment (see below) helped to lift this figure, but the main impetus came from wage hikes for people already holding jobs. For example, heads of households received pay increases in the neighborhood of 4 percent a year in the 1984-85 period. With semiannual bonuses and second incomes also up and some rise in investment income, the average Japanese household headed by a wage earner saw its income advance in nominal terms by 3.2 percent in 1983, 4.6 percent the next year and 4.9 percent in 1985, which corresponded to real increases of 1.2 percent, 2.4 percent and 2.8 percent, respectively. Even with a slightly heavier personal tax burden over this period, the fact remained that disposable income rose both before and after adjustment for inflation. Returning to the example of the average employee's household, the increase worked out to 4.4

percent in 1984 and 4 percent in 1985 in current prices and roughly 2.2 percent and 1.9 percent in real terms.

As is always the case, the rising cost of goods and services forced Japanese consumers to spend part of their higher disposable income just to maintain the same standard of living. Citing the most obvious example, the price of food — the single largest living expense at about one-fourth of total household expenditures — went up by 1.7 percent in 1985 after increasing by 2.8 percent the year before. It was clear, nevertheless, that consumers had the resources to expand spending by more than they did.

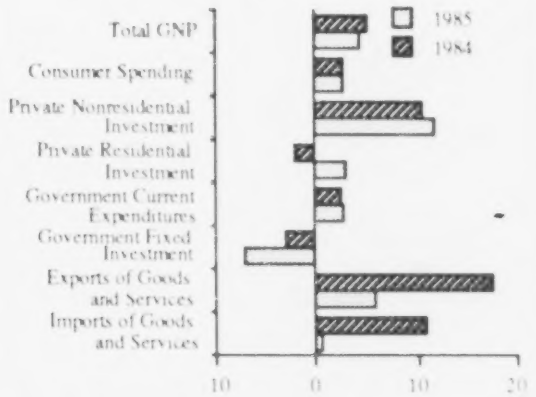
The question of why the spending spree that figured so prominently in the U.S. recovery and subsequent expansion did not materialize in Japan never received a definitive answer. But there was a leading candidate: Japanese consumers had become less confident about their economic prospects and were therefore saving more, whether for retirement, emergencies or purchases requiring major outlays like home ownership. Some versions of this line of reasoning went on to argue that in this environment of growing consumer uncertainty, Japan's system of tax-free saving increasingly skewed the consumption-saving decision in favor of saving. Whatever the merits of this argument, personal saving did increase in Japan in marked contrast to what happened in the United States. For example, the average worker household, which had earmarked just under 21 percent of disposable income for saving annually between 1981 and 1983, upped the proportion to 21.3 percent in 1984 and then to 22.5 percent in 1985.

The weakness in residential construction, which dropped by another 2.1 percent in 1984 in real terms before finally going up by 3.2 percent the following year, was less perplexing. For starters, low population growth plus the increasing number of people 65 years old and over continued to slow the formation of households. The flip side of this development was that the ranks of potential first-time home owners were thinned by the declining number of people in the 25- to 34-year-old category.

Then there was the constraint of the run-up in the total cost of home ownership. Steadily rising housing prices in major metropolitan areas were the main part of the problem, especially given signs of spreading consumer uncertainty about the future, but the level of mortgage rates also entered into the equation. Although rates continued to drift down in the mid-1980s, they were still not low enough to stimulate demand significantly. Rates on mortgages provided by nationwide commercial banks, the biggest source of private-sector money, averaged 7.7 percent in late December 1985 compared with 8.1 percent at the end of 1983. Complicating the financing picture, the government's fiscal austerity program meant less money for the Housing Loan Corp. to provide low-cost mortgages.

Japan's GNP by Sector

percentage change in real terms



Source: Economic Planning Agency

A look at the data on residential construction starts underscored the point that many households continued to be priced out of the market. Total starts expanded by 4.1 percent in 1985 to 1.2 million-plus units on top of a year-earlier gain of 4.4 percent, but the only category to post an increase in both years was rental units. In fact, the number of rental units started exceeded owner-built units for the first time in 1985.

Residential construction was not the only casualty of Tokyo's fiscal austerity drive: domestic demand as a whole lost a major source of stimulus. Government purchases of goods and services at both the national and local levels had a neutral impact on growth in 1984 as a 2.9 percent drop in inflation-adjusted fixed investment cancelled out a 2.5 percent gain in current expenditures. The story was much the same in 1985, although there was a slight twist to the ending. Current government expenditures continued to rise modestly, this time by 2.6 percent, while investment outlays declined 6.9 percent — the fourth straight year of contraction. Netted out, these figures indicated the public sector had a small negative impact on the economy's performance. But the size of the reduction in investment spending was misleading since the big equipment budget of Japan's domestic telecommunications monopoly was shifted in the national income accounts to the business investment category following the April 1 privatization of Nippon Telegraph and Telephone Public Corp. (see below).

Not only did government at the national and local levels make no contribution to growth on an annual basis, but Tokyo's attempts to influence the economy's course from one quarter to the next through changes in its spending

pattern fell flat. Front-loading public works expenditures into the first half of the fiscal year (April-September) — one of the few ways a government committed to fiscal austerity can give the appearance of carrying out a more expansive fiscal policy — did not fool the market since front-loading had become standard practice. Moreover, the government's attempt to stimulate demand by passing a supplementary budget in December 1984 did little more than produce a one-quarter blip in the government's economic input in the January-March 1985 period because this budget, like the regular one, was also a victim of restraint.

With consumer spending and residential construction muddling along and the government out of the stimulus picture, business investment became the driving force of domestic demand. In 1984 capital spending, which had languished the two previous years, jumped by 10.9 percent in inflation-adjusted terms; its 1985 performance was an even stronger 11.9 percent. These were impressive numbers by any standard, but more so because annual plant and equipment expenditures had not increased by back-to-back double-digit margins since the 1969-70 period. Still, the true strength of capital spending was better conveyed by another pair of statistics: business investment was responsible for 1.7 points of the economy's 5.1 percent real growth rate in 1984 and for 2 points of the 4.5 percent gain in 1985 output.

Indirect evidence suggested that the biggest share of plant and equipment outlays in the 1984-85 period was earmarked for capacity expansion in manufacturing, particularly in the huge electric machinery industry, by far the sector's largest investor. Production capacity, already up by 8.6 percent between 1980 and 1983, increased by 3.8 percent in 1984 and by an additional 4.5 percent the next year. Despite the substantial amount of new plant and equipment coming onstream, the manufacturing operating rate moved up in both years after slipping during the slow growth period of the early 1980s. What this development obviously meant was that industrial production was expanding at an even faster pace — to be exact, 11.1 percent in 1984 and 4.6 percent in 1985.

Expansion also appeared to be the primary reason for stepped-up investment in the tertiary sector, which outspent manufacturing by roughly 15 to 20 percent a year in the mid-1980s. Construction of commercial buildings for sale or lease and work on electric power plants, transmission lines and the like continued to dominate activity in this area. For electric utilities, at least, plant and equipment modernization, including the conversion of generating plants from one fuel source to another, was a close second in terms of outlays.

Modernization probably ran neck and neck with expansion in manufacturing as well. Electronics companies, no doubt, spent almost as much to upgrade plants already in operation as to build new ones. For automotive makers, though, the rankings might have been reversed. Although the manufacturing sector's number-three investors put money into capacity, primarily overseas, it would not be surprising if they earmarked more to reduce production costs at existing factories. The investment pattern of chemicals manufacturers, the second-largest investors, illustrated an alternative requirement for funds: rationalization in basic industries that are no longer internationally competitive — in this case, the petrochemicals industry.

Whatever the reason for investing, Japanese business generally had more money in the mid-1980s to finance capital spending internally. Sales of all industries increased 7.6 percent in FY 1984 (April 1984-March 1985), and with the rise of costs held in line, net income soared 23.2 percent. The manufacturing sector showed the biggest improvement in profit margins, lifting sales by 3.7 percent but boosting net profits by 24.4 percent. The situation was somewhat different in the April 1985-March 1986 accounting period. Despite an additional 6.9 percent gain in total industry sales, net profits slipped 1.1 percent. Paradoxically, manufacturers bucked the overall decline in net income despite the adverse effects of the strengthening yen in the second half of the fiscal year. Their net profits edged up 0.9 percent on a sales increase of 7.8 percent.

External Demand With capital spending becoming the economy's main engine of growth in the 1984-85 period, net external demand assumed the function of backup engine. This assertion obviously runs counter to a lot of the conventional thinking in the United States about the export dependency of the Japanese economy, but disbelievers need only look at the national income accounts for proof. Of the 5.1 percent expansion in inflation-adjusted GNP in 1984, net foreign demand was responsible for 1.3 points. In 1985 it played an even smaller role, generating 1 point of the 4.5 percent rise in economic output.

Like all conventional wisdom, there was an element of truth in the thinking about the importance of exports to the strength of the Japanese economy's performance, particularly in 1984. In that year of worldwide economic recovery, real exports of goods and services jumped by 17.5 percent and added 3 points to the upturn. But there was a major offset: imports of goods and services in volume terms also jumped, climbing by 11.1 percent and subtracting more than 1.6 points from the year's growth rate. The situation was very different in 1985. Overseas sales continued to advance but at the scaled-back rate of 5.9 percent, which trimmed the contribution of exports to the expansion to just 1.1 points. At the same time, the expansion of imports lost most of its steam, with purchases rising by just 0.7 percent for a mere 0.1 point reduction in economic output.

The poor showing of imports in 1985 against the backdrop of still rising exports kept Tokyo on the defensive on trade matters. From a strictly domestic standpoint, however, Japanese policymakers had a more pressing problem on their hands — the big swings from one quarter to the next in net external demand. These ups and downs, largely the product of erratic exports, underscored just how vulnerable the economy's health was to forces outside its control in the absence of broadly based strength in domestic demand.

Labor Japan's employment picture in the mid-1980s was bright in comparison with other industrial countries but bleak by historical standards. Approximately 330,000 jobs were created in 1984, with another 410,000 added in 1985. Perversely, however, the economy generated fewer new positions in either year than at any other time in the decade even though growth was stronger. Equally troubling, the unemployment rate set a postwar record of 2.7 percent in 1984 despite the fact that real GNP expanded by the biggest margin in five years. The jobless rate returned to its 1983 level of 2.6 percent in 1985, but this average masked a steadily deteriorating job market. Unemployment, which had started out the year at 2.5 percent, reached an all-time monthly high of 2.9 percent in December.

Whatever else happened on the labor front, one thing did not change: Japanese workers in the manufacturing sector continued to score impressive productivity gains. Output per worker jumped by 10 percent in 1984 before easing to 4.2 percent growth the next year — a pattern that is normal for an economy moving from the recovery phase to the expansion stage. Sustained productivity gains like these gave employers room to hike wages significantly while still keeping the rise of unit labor costs under control. But much to the disappointment of government officials banking on substantial increases to pull consumer spending out of the doldrums, pay raises were no bigger in the mid-1980s than in earlier years.

Manufacturing employees received increases averaging 4.6 percent in 1984 and 4 percent in 1985, which corresponded to real gains of 2.4 percent and 2 percent, respectively, while all private-sector nonfarm workers saw their 1984 paychecks expand by 4.5 percent (2.3 percent real) and their 1985 wages go up by 3.6 percent (1.5 percent real). The macroeconomic consequences of these moderate settlements were obvious. Japanese manufacturers maintained their competitiveness in international markets as unit labor costs fell by an estimated 5.8 percent in 1984 and then inched up roughly 1.2 percent the next year, but domestic demand was denied the benefit of a potentially major source of stimulus.

Inflation Japan's efforts to keep inflation in check after the harrowing experiences of the 1970s were highly successful in the mid-1980s. Wholesale prices, in fact, slipped 0.3 percent in 1984 and declined by another 1.1 percent the next year after already falling by 2.2 percent in 1983. Weakening energy prices, the ongoing drop in the prices of other industrial inputs that Japan imports in large volume plus the strengthening yen in 1985 helped to push down wholesale prices by trimming yen-based import prices 3.4 percent in 1984 and 2.5 percent in 1985. But simply because of the way the producer price index is structured, stable to weaker prices for domestic products — themselves partly a reflection of the moderate wage increases of this period — were a bigger factor in the drop of prices at the wholesale level than falling import prices.

The fact that wholesale prices for domestic products were barely higher in 1985 than in 1980 had an important international angle since it meant that there was no pressure on export prices. Actually, yen-based export prices declined a little more in 1985 than domestic prices (1.4 percent versus 0.8 percent) after rising marginally faster the year before (0.6 percent compared with 0.1 percent). This suggested that Japanese exporters were paring back their prices to maintain market share abroad in the face of the yen's rising value. The exception to this scenario, of course, was the automotive industry, which capitalized on strong overseas demand and restraints on shipments to the United States and other markets and raised prices.

With wholesale prices edging down, consumer prices remained very steady — increasing just 2.1 percent in 1985 on top of gains of only 2.2 percent the previous year and 1.9 percent in 1983. While medical costs, educational expenses and clothing prices were up fairly strongly in 1985, food costs, which represent nearly two-fifths of the consumer price index, rose just 1.7 percent. Also helping to keep inflation in check were the limited (2.1 percent) increases in the costs of transportation and recreation — the index's second-largest components — as well a dip in utility bills due to cheaper oil imports.

Monetary Policy

The low rate of inflation in Japan in the mid-1980s gave monetary authorities the leeway to maintain a cautiously accommodative stance. Many analysts and business leaders were convinced, however, that a more expansionary policy was appropriate, particularly in 1985 when the economy showed signs of a slowdown. But the Bank of Japan's hands were basically tied. The substantial interest rate differential between Japan and the United States forced the central bank to pursue a more restrictive monetary policy than was warranted by domestic economic conditions to limit capital outflows that would put downward pressure on the value of the yen.

In marked contrast to the accelerating increase in the U.S. money supply during the 1984-85 period, the Bank of Japan kept money growth within a relatively narrow, moderate range. The broad measure of the money supply — M2 (currency and demand and time deposits) plus certificates of deposits — expanded by an average 7.8 percent in 1984, with monthly increases only straying above 8 percent on three occasions. Growth was slightly faster in 1985, particularly in the fourth quarter. Through September increases were running just under 8.2 percent, but in the October-December period growth came in at 9 percent. What appeared to be signs of an easier BOJ policy stance was in fact partly the result of financial innovation (changes in the regulations governing large-denomination time deposits) and partly a reflection of increased borrowing from banks in anticipation of higher lending rates, a development noted below.

While the Bank of Japan was broadly accommodative in money growth, it did not have the same maneuvering room on the discount rate, the central bank's main policy tool. Here it faced an unacceptable trade-off: responding to the increasingly frequent calls of the business community for a rate cut to spur the economy would have widened the disparity between interest rates in Japan and the United States, in turn encouraging capital outflows and lowering the yen's value on foreign exchange markets. The BOJ therefore opted to keep its discount rate fixed at 5 percent throughout the 1984-85 period.

This decision meant that all interest rates tied to the discount rate — the short-term lending rate at commercial banks and the interest rates paid by banks and the postal savings system on "small" deposits — remained constant in 1984 and 1985. It also meant that while market-determined short-term interest rates — for example, call rates and bond repurchase yields (*gensaki* rates) — wandered up and down, they showed little change on balance. There was, however, one major exception. Between mid-October and mid-December 1985 the Bank of Japan engineered a run-up in short-term market rates to support the yen's appreciation following the Group of Five agreement in late September to lower the value of the dollar (see Part II).

Although short-term rates were fairly stable, market-determined long-term rates drifted down in the mid-1980s. The prime rate — which on paper is freely set by the long-term credit banks but in reality is subject to government guidance — was cut twice in 1984, ending the year at 7.6 percent. In 1985 the rate was raised almost as many times as it was reduced, including late in the fourth quarter as a result of the BOJ's actions to strengthen the yen; as the year closed, however, the prime fell to 7.2 percent. The rates on 10-year government bonds in the resale market similarly moved up and down, but the net result of these fluctuations was lower yields — an average 7.3 percent for 1984 and 6.5 percent for 1985 compared with 7.8 percent in 1983.

Fiscal Policy

With monetary policy constrained by worries over the impact of a more expansionary stance on the yen's value, the job of keeping the economic expansion going rested with fiscal policy. Here, too, powerful constraints were at work. Prime Minister Yasuhiro Nakasone had made fiscal reconstruction one of the hallmarks of his administration, and neither he nor the Ministry of Finance was prepared to abandon this goal despite intense debate over the wisdom of continued austerity. At best, therefore, fiscal policy had no stimulative impact on the economy's performance in the mid-1980s; at worst, it was a slight drag on activity.

FY 1984 Budget Prime Minister Nakasone's cabinet continued to attack the budget deficit problem in FY 1984 through a tough program that reduced discretionary spending (total general account outlays minus debt servicing costs and transfers to local governments) and raised both direct and indirect taxes. The budget for the April 1984-March 1985 period, adopted by the cabinet in late January 1984, was expected to grow only 0.5 percent from FY 1983's level, reaching ¥50.6 trillion.

The expenditure side clearly revealed Mr. Nakasone's priorities. Every discretionary budget item was cut with the following notable exceptions: defense (up nearly 6.6 percent to ¥2.9 trillion), foreign aid (up 7.9 percent to ¥544 billion), science and technology promotion (up 3.2 percent to ¥411 billion), and energy programs (up 0.9 percent to ¥603 billion). Equally notable were some of the programs cut — public works, the food control account and pensions, to name just a few. Due to the deep cuts in programs like these, discretionary spending was projected to fall 6.6 percent from FY 1983 levels to ¥32.6 trillion. But these reductions were expected to be more than offset by increases in the budget's two nondiscretionary categories: national debt payments (up 11.7 percent to ¥9.2 trillion) and transfers to local governments (up 21.5 percent to ¥8.9 trillion).

On the revenue side, it was projected that the general budget would get 68.3 percent of its funds (¥34.6 trillion) from taxes, up from 64.1 percent the year before, even though the second stage of a two-year cut in income and residence taxes was to be made in FY 1984. The plan hoped to recover the lost revenues through new taxes on luxury goods, higher motor vehicle taxes and a temporary 2 percentage point surcharge on corporate taxes. Non-tax revenues were predicted to drop 29 percent from FY 1983 levels to ¥3.4 trillion or 6.6 percent of total revenues. Simple arithmetic indicated that even with the lid on expenditures, there would be a revenue shortfall of roughly 25 percent in the FY 1984 budget. Yet Mr. Nakasone could claim that he was slowing the growth of the national debt since new issues of government bonds were expected to fall 5 percent from their FY 1983 total to ¥12.7 trillion.

Any lingering hopes that Tokyo would relent and provide some fiscal stimulus in FY 1984 evaporated when the Fiscal Investment and Loan Program showed the same signs of belt-tightening as the general account budget. Expenditures under the FILP, which is used primarily to fund infrastructure projects and is financed mainly by the postal savings system, were scheduled to rise just 1.9 percent to ¥21.1 trillion. Some major program areas, including water works and roads, were given increases, but housing construction, the single largest outlay, and a long list of other areas were targeted for cuts.

Although more firmly wedded to a policy of fiscal austerity than ever, the government reverted to form and proposed a supplementary budget for FY 1984. Approved by the Diet in late December 1984, this extra budget added ¥886 billion to spending, including ¥187 billion for emergency disaster relief and ¥144 billion for an increase in civil servants' pay. Yet the 1.8 percent increase in general account expenditures was too small to change the fact that the FY 1984 budget was not a source of economic stimulus. If anything, it was less expansionary than the one for the previous fiscal year since a smaller proportion (an estimated 25 percent versus a projected 26.5 percent) was expected to be deficit financed.

FY 1985 Budget In a continuing effort to balance the budget, the government clamped the same tight lid on discretionary spending in FY 1985 as in the three previous fiscal years. As approved by the cabinet in late December 1984, expenditures totaled just under ¥52.5 trillion, a 3.7 percent increase over FY 1984's initial budget. It may appear that Mr. Nakasone heeded calls from some quarters of the Liberal Democratic Party and the business community for a stimulative fiscal policy since the FY 1985 budget increase was far in excess of the 0.5 percent rise set for the previous fiscal year. Discretionary spending, however, was pushed just below the FY 1984 level of ¥32.6 trillion. In addition, the shrinking budget pie continued to be reapportioned in line with the prime minister's free market and pro-defense philosophies.

Budget winners and losers were evenly divided, with defense (up 6.9 percent to ¥3.1 trillion), economic cooperation, including official development assistance (up 7.8 percent to ¥586 billion), and energy-related programs (up 4.2 percent to ¥629 billion) getting the thumbs-up. A 14.5 percent cut in the food control account headed the list of line items under the ax, followed by small business measures (falling 5.7 percent), public works (off 2.3 percent), pensions (dropping 1.2 percent), and outlays for education and science and technology (shrinking 1.1 percent). No one was surprised at the increases in economic cooperation and defense, but the cuts in politically sensitive public works, pensions and education raised some eyebrows, especially inside LDP chambers. In truth, Mr. Nakasone was simply reducing the government's active role in these areas in exchange for tax incentives for investment and research, and reforms in the national pension system. Total government outlays on public works projects actually rose substantially through redirecting funds from gasoline taxes and special accounts.

The tight lid on discretionary spending was necessary simply because transfers to local governments were set to increase by 9 percent to ¥9.7 trillion, while debt service payments were expected to rise almost ¥1.1 trillion to a whopping ¥10.2 trillion. The 11.7 percent jump in interest payments to nearly one-fifth of the general account budget made this the single largest expense. Finance Ministry officials could, however, point to some improvement in the situation since issues of new government bonds in FY 1985 were pegged initially at ¥11.7 trillion, down a full ¥1 trillion from the previous fiscal year. This decline cut the government's dependence on borrowed funds to a projected 22.2 percent of general account expenditures from FY 1984's estimated 25 percent.

Other parts of the revenue side of the FY 1985 budget were equally revealing. In addition to the drop in receipts from bond issues, non-tax revenues were forecast to fall 32.3 percent to ¥2.3 trillion, increasing the pressure for additional tax revenues. Tax receipts, however, were already budgeted at ¥38.6 trillion, up 11.4 percent on the basis of various changes affecting the taxes paid by corporations and several modifications in local taxes. These changes intensified the debate over the tax system's equity, and for the first time in 10 years, the government and LDP tax councils disagreed heatedly over several issues. Both groups stressed that FY 1985's tax measures were stopgaps at best and that basic systemic reform was needed (see discussion below).

An even clearer indication of Tokyo's fiscal mood was the reduction in the Fiscal Investment and Loan Program — the first cut in this secondary budget in 31 years. With FILP outlays projected to fall by 1.2 percent to ¥20.9 trillion, there were few winners, although water works and roads were again on the list. Once more among the losers was housing construction, for which no increase was budgeted.

Post-FY 1985 Budget Activities With the economy sputtering in 1985, Prime Minister Nakasone came under increasing pressure to prime the pump. His own Liberal Democratic Party called on the government in mid-July to begin several large highway and other infrastructure projects. Japan's trading partners added their voices to the fiscal stimulus chorus, arguing that the country's high saving rate could accommodate both more deficit financing by Tokyo and strong business investment. Within the government the Ministry of International Trade and Industry continued to be the main advocate of increased spending, but

this time around it found a key ally in the Ministry of Construction, headed, interestingly, by a member of Mr. Nakasone's LDP faction. Both ministries outlined major infrastructure investment programs in mid-August featuring a big financial role for the private sector and/or local governments — a common twist designed to make them more salable to an austerity-minded prime minister and Finance Ministry.

Although the calls at home and abroad for action to spur faltering domestic demand received a cool reception at first, the Nakasone administration finally bent on the question of a stimulus package. The plan endorsed by the cabinet on October 15, 1985, however, was short on initiatives that would require direct government outlays — a clear sign that keeping the expansion going still took a backseat to reducing the budget deficit. Government officials implicitly conceded that the package would have only a modest impact on demand when they predicted that the proposed ¥3.1 trillion in extra spending would add just ¥4.1 trillion, or about 1.3 percent, to FY 1985's projected nominal GNP after factoring in multiplier effects.

One of the plan's main targets was to boost flagging housing starts. To this end, the Housing Loan Corp. was authorized to provide an additional 20,000 below-market-rate mortgages during FY 1985 for a total of 510,000. This move, it was estimated, would generate ¥500 billion or so in new expenditures. In addition, parcels of public land in urban areas were to be sold to developers, which were expected to spend some ¥400 billion on the construction of commercial buildings. The package did provide for some increase in public works spending underwritten by the central government, but Tokyo was banking on local governments to step up their investment when it projected that the package would create an additional ¥1.8 trillion-plus in public investment.

The rest of the stimulus package consisted of a grab bag of measures. One was an old standby — asking electric utilities and gas companies to move up ¥400 billion in planned capital spending. The government also announced that it would ease the terms of consumer loans for cars and color television sets in an attempt to lift sluggish spending on durables. In a similar vein, Tokyo said it would push businesses to give employees an extra 10 days a year of paid leave. Rounding out the list of measures was the government's renewed pledge to promote greater economic efficiency via further deregulation and the injection of "private sector vitality into public works projects."

This slim package did not deter supporters of a reflationary fiscal policy. They tried to persuade the government to expand the supplementary FY 1985 budget beyond what was needed to implement Tokyo's part of the stimulus program, but their campaign again met with failure. The extra budget approved by the Diet in December 1985 came to a modest ¥723 billion — ¥163 billion less than the supplementary budget for FY 1984. Needless to say, the 1.4 percent rise in general account spending — devoted mainly to disaster relief, increased funding for the HLC and a pay hike for government employees — did little to alter the basically restrictive economic impact of Tokyo's budget policies.

FY 1986 Budget Process The Ministry of Finance's efforts to reduce the budget deficit seemed to be unraveling during the compilation of the FY 1986 budget. Although the cabinet-approved guidelines for drafting the budget once again specified a 10 percent cut in non-personnel discretionary spending by most ministries and agencies and a 5 percent reduction in public works funds, initial requests added up to a 7.4 percent increase over fiscal 1985's level. Even more than in other years, this forced the cabinet to grapple with spending priorities.

Prime Minister Nakasone had put his personal reputation behind an effort to include a 7 percent increase in defense outlays in the budget guidelines. Similarly, the Foreign Ministry succeeded in getting a 10 percent gain penciled in for foreign aid. Perhaps sensing from this that MOF's hard line was weakening, other ministries came in with larger-than-expected requests. The most worrisome item in the calculations was the projection for debt service payments — up a steep 26.9 percent.

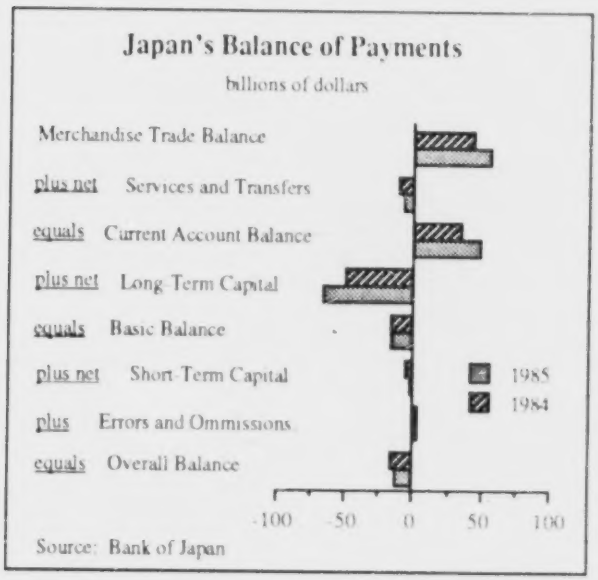
When the dust settled in late December 1985, the cabinet had accepted a ¥54.1 trillion general account budget for the year starting in April 1986, 3 percent more than FY 1985's initial level. The line was held on discretionary expenditures for the fourth straight year, although more money was allocated for defense (up 6.6 percent), economic cooperation (up 6.3 percent) and a short list of other programs. Moreover, the government could claim victory in its continuing battle to rein in the expansion of nondiscretionary spending. The increase in transfers to local governments was trimmed to 5.1 percent, while the growth in debt servicing costs was scaled back to 10.7 percent. Still, at a projected ¥11.3 trillion in FY 1986, debt payments represented 20.9 percent of all outlays.

The government could also claim progress on another front: reduced dependence on deficit financing. An estimated 20.2 percent of the FY 1986 budget or just under ¥11 trillion was to be covered by borrowing, down 2 percentage points from the previous fiscal year. The flip side of less deficit financing was greater reliance on tax revenues, which were expected to increase by 5.2 percent to nearly ¥40.6 trillion — a highly optimistic projection considering the predictions of slower economic growth in the April 1986-March 1987 period. But whatever might happen to the economy, one thing was clear: business would have to shoulder a heavier tax burden in the upcoming fiscal year.

Accepting the obvious, the cabinet made no attempt to portray the FY 1986 general account budget as a source of economic expansion, but government officials did try to cast the FILP budget as a response to the multiplying calls for fiscal stimulus. They faced an uphill battle. True, expenditures were scheduled to increase after being cut in FY 1985. The fact remained, though, that the projected 6.2 percent rise in outlays to ¥22.2 trillion only returned spending to its FY 1984 level.

Balance of Payments

Japan's burgeoning trade surplus in the mid-1980s kept Tokyo constantly on the defensive in its relations with other countries, first and foremost the United States but European nations and Asian neighbors as well. Yet this was just the most visible international fallout. Generally overlooked was the fact that Japan's ballooning earnings from trade were recycled back into the global economy in the form of massive capital movements. These outflows made Japan the world's number-one creditor nation at the end of 1985.



Merchandise Trade Like the U.S. trade deficit, Japan's merchandise trade surplus on a balance of payments basis seemed to take on a life of its own in the mid-1980s. The most surprising aspect of this development was that the changes in Japanese exports and imports from one year to the next were not very large on a percentage basis. Overseas sales, for example, increased by only 3.4 percent in 1985 after going up by a moderate 15.7 percent the year before and by 5.7 percent in 1983. Conversely, while 1985 purchases from abroad declined following an 8.8 percent gain in 1984, they were down just 4.8 percent, or by virtually the same margin as in 1983. But the combination of these two sets of growth rates was explosive. Already up by three-fourths in 1983 to a then-record $31.5 billion, Japan's trade surplus jumped to $44.3 billion in 1984 and then to a whopping $56 billion.

While Japan's soaring trade surplus was the product of multiple factors, two were paramount: the relative strength of the U.S. economic recovery and subsequent expansion, and the misalignment of the yen-dollar exchange rate. By itself, the strong performance of the American economy would have triggered a substantial increase in exports; the addition of an overvalued dollar, which gave Japanese suppliers a pricing edge on their American rivals in both the United States and third markets, guaranteed this outcome. On the other side of the equation, the less-than-robust state of domestic demand in Japan put a damper on imports. So did the dollar's high value since the bulk of the country's overseas purchases are priced in dollars.

Services The decline in Japan's traditional deficit in services trade, which fell from $9.1 billion in 1983 to $5.2 billion in 1985, was almost entirely the result of a big increase in investment income, particularly from portfolio investments. The net figure more than doubled, rising from $3.1 billion to $6.8 billion, as earnings from Japanese assets invested abroad climbed by $3.3 billion in 1985 to $22.1 billion after expanding by almost the same amount the year before while income from foreign investments in Japan went up by smaller margins — $2 billion in 1984 and $0.7 billion in 1985 to $15.3 billion. There was also some improvement in the transportation category, with 1985's $2.6 billion-plus deficit $0.6 billion less than the 1983 entry. In contrast, the deficit in travel was stuck at the $3.6 billion level and payments for fees and royalties continued to exceed receipts by roughly $5 billion.

Current Account From 1970 to 1980 Japan's current account was basically in balance, averaging a small annual surplus of $1.8 billion. But after recording a $10.8 billion deficit in 1980 following the second oil shock, the current account moved rapidly into the black, propelled by the ballooning margin between exports and imports of goods and the shrinking deficit in services. From just $4.8 billion in 1981 and $6.9 billion the next year, the surplus soared to $20.8 billion in 1983 and then seemed to take on a life of its own, hitting $35 billion in 1984 and $49.2 billion in 1985. This swelling surplus led some observers to compare Japan to the Organization of Petroleum Exporting Countries, which, as a group, posted a current account surplus of $100 billion in 1980.

Capital Flows Japan's huge current account surpluses were offset by equally huge net long-term capital outflows, which increased from $17.7 billion in 1983 to a whopping $64.5 billion two years later. While 1985's capital inflow of $17.3 billion was hardly bigger than 1983's, the flow of

money out of the country surged from $32.5 billion to $81.8 billion in 1985 — a volume that transformed Japan into the major capital supplier to the world. This new and not entirely comfortable role reflected Japan's domestic saving-investment imbalance. Its household saving rate remained high by international standards (roughly three times the U.S. rate in 1985, for example). At the same time, domestic demand for capital declined, both because Tokyo's austere fiscal policies reduced the government's borrowing requirements and because business was not as dependent on outside financing for plant and equipment investment as it used to be. Against this backdrop, Japanese individuals and institutions shifted more of their abundant capital into foreign assets, a movement facilitated by the liberalization of controls on capital flows.

Net purchases of foreign bonds accounted for three-fourths of Japan's net capital outflow in 1985. The great interest in overseas bonds was illustrated by the leap in two-way trading from $33.3 billion in 1983 to $529.2 billion in 1985, with net purchases increasing by more than four-fold to $53.5 billion.

Attracted by high real U.S. interest rates and the size and liquidity of American capital markets, Japan's net long-term capital outflow to the United States reached $33.2 billion in 1985. Net purchases of U.S. securities alone totaled almost $30 billion as Japanese investors played a significant role in financing the federal budget deficit. According to the Treasury Department, net purchases of U.S. Treasury notes and bonds by Japanese institutions in 1985 totaled $19.2 billion, accounting for 12.8 percent of new Treasury financing that year.

Net Japanese direct foreign investment also increased sharply in the mid-1980s, climbing from $3.2 billion in 1983 to $5.8 billion in 1985, but it remained small by international standards. According to the Japan External Trade Organization, the outstanding stock value of Japan's direct investment at the end of 1984 was equivalent to 3.2 percent of GNP, compared to 6.4 percent for the United States, 7.3 percent for West Germany and 17.2 percent for Britain.

As a result of Japan's huge trade surplus and corresponding capital outflow, its net external assets, which totaled only $11.5 billion at the start of the 1980s, increased by leaps and bounds. By the end of 1985, in fact, Japan was the world's largest creditor nation, with $129.8 billion in net assets. In that year alone, its overseas assets climbed by 28.3 percent to $437.7 billion, led by a $58.2 billion jump to $145.8 billion in holdings of foreign securities — a figure equal to well over half of the private sector's long-term foreign assets. Needless to say, this rapid accumulation of foreign assets had important implications for Japan's current account balance in future years.

Trade

The export and import numbers that foreign policymakers and analysts alike generally track — dubbed the customs clearance data — put Japan's surplus in any one year roughly $10 billion below the comparable figure in the balance of payments since imports are reported on a higher cost, insurance and freight basis. This did not change the fact that the country's trade results in the mid-1980s kept Tokyo on the international hot seat. Whatever the exact size of the black-ink entry, it was increasing nonstop at a time when the United States and many of Japan's other trading partners were struggling with the economic and political fallout from expanding trade imbalances, both bilaterally and overall.

Japanese exports, which had snapped back 5.8 percent with the 1983 world economic rebound, advanced by 15.8 percent in 1984 to $170.1 billion as the international economy moved from the recovery phase to the expansion stage. While substantial, this gain was in line with the growth of overseas shipments in the 1980-81 period. In fact, a bigger increase would not have been surprising given the strong showing of the American economy in 1984, the jump in export earnings in most other countries from larger sales to the United States and the impact of the overvalued dollar on the price competitiveness of Japanese suppliers. But the expansion of Japan's aggregate exports was checked by the weakness of domestic demand in Europe and the lower revenues of oil producers.

The European constraint lessened in 1985, but exporters had a new problem on their hands — the slowdown in the American economy. This development trimmed the growth of U.S. import demand, whether for products made in Japan or elsewhere, thereby capping the rise in Japan's overseas sales both directly and indirectly via the effect on shipments to third markets. As a result, total exports expanded by a modest 3.2 percent in 1985 to $175.6 billion.

On the other side of the ledger, the pickup in Japanese economic activity in 1984 finally produced a turnaround in imports after a two-year decline. The rally was actually stronger than the 8 percent gain to $136.5 billion indicated since weakening international prices for the industrial inputs and agricultural raw materials that Japan buys in huge quantities shaved hundreds of millions of dollars off the import bill. To give just one example, albeit the key one, falling crude oil prices alone save importers $684 million even after factoring in a 3 percent rise in purchases. A better reading of the impact of the 1984 economic upturn on import demand was provided by the volume index, which was up by 10.7 percent.

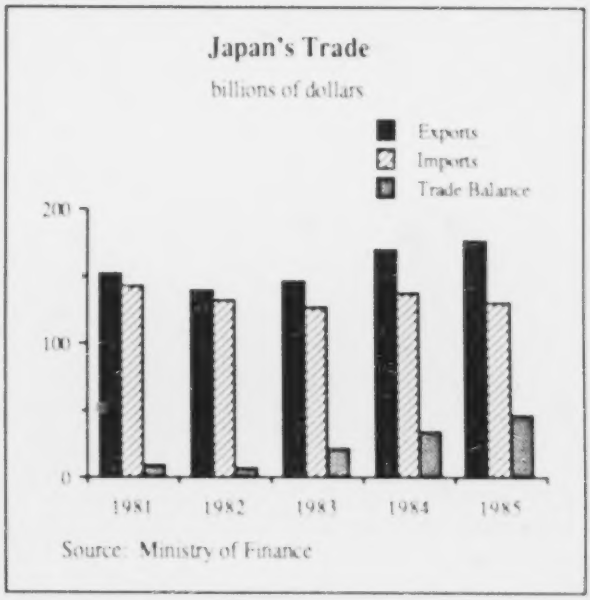
In a replay of what happened in the United States, Japanese import demand tapered off in 1985 in response to

the economy's slower pace. In fact, purchases from abroad declined again, this time by 5.1 percent to $129.5 billion. But because of the continuing fall in world prices for bulk materials, the value figure overstated the extent of the downturn. The volume index showed imports up by a slim 0.2 percent, although even this number was slightly misleading since the quantity of crude oil imported, which makes up one-third of the index, decreased by 8.1 percent in 1985.

With exports and imports moving in basically different directions in the mid-1980s, the bottom line was obvious: Japan's trade surplus, which had tripled in 1983 to a new record of $20.5 billion, shot up to $33.6 billion in 1984 and then climbed by almost the exact same amount in 1985, hitting $46.1 billion. By itself, this surge signaled tough times ahead for Tokyo in its international economic dealings, but from a bilateral standpoint there was a more ominous statistic — more than four-fifths of the widening gap between Japan's exports and its imports was the outgrowth of trade with the United States. Put another way, the black-ink entry with this country ballooned from $18.2 billion in 1983 to $39.5 billion two years later as U.S.-bound shipments jumped by an incredible 39.9 percent in 1984 before slowing down to an 8.9 percent gain and purchases of American commodities and products first increased by 9 percent and then dropped by 4 percent.

Just as eye-catching as the virtually one-to-one relationship between Japan's soaring overall trade surplus and the change in its trade account with the United States was the fact that a relative handful of products was responsible for the export expansion. Not surprisingly, automotive products were at the top of this list. Increased overseas sales of cars generated one-fifth of the gain, climbing from $19.5 billion in 1983 to $24.5 billion in 1985 on a shipment increase of just under 0.9 million vehicles to 5.2 million units. On top of this growth there was a $2.4 billion jump in exports of trucks and buses to $8.9 billion and a $1.8 billion rise in exports of automotive parts to $5.2 billion.

Most of the other products on the short list of fast-expanding exports were also familiar. Take, for example, office equipment, which went up by nearly $2.7 billion to $7.8 billion largely on the strength of much higher foreign sales of computers, peripheral equipment and parts, or video cassette recorders — up $1.3 billion to $6.6 billion despite steadily falling prices. Scientific and medical equipment also made the list with a $1.8 billion gain to $10 billion, as did semiconductors. Rounding out the top 10 were three products that scored less spectacular increases: steel (up from $12.8 billion in 1983 to $13.6 billion in 1985 although this figure was still well below the export levels of the early 1980s), chemicals ($0.7 billion higher at $7.7 billion) and nonelectric power generating equipment (an $0.8 billion rise to $3.8 billion).



Big import gains were also few and far between, but this result was primarily a reflection of the ongoing decline in world market prices of the industrial supplies and food and feed commodities that account for roughly three-fourths of Japan's purchases from foreign suppliers. What happened to crude oil imports in the mid-1980s provided the most graphic demonstration of this development. Although the continuing switch to other energy sources plus conservation cut the volume of deliveries by 5.3 percent from 1983's level of 207 million kiloliters to 196 million kiloliters in 1985, the import value dropped by a whopping $4.8 billion to $34.6 billion for a 12.1 percent reduction. This example, however, had a major drawback since the quantity figures expanded for a number of other key industrial inputs, including coal, nonferrous metals, iron ore, pulp and cotton.

While Japan's overall import numbers put Tokyo on the defensive, it could justifiably tout the growth in purchases of foreign-made manufactured products, especially since this expansion occurred against the backdrop of a strong dollar. Imports of manufactures increased 14 percent between 1983 and 1985 to $36.4 billion. Partly behind this advance were bigger purchases of computers, peripheral equipment and parts, which climbed by $0.5 billion to $1.5 billion, and other high technology products like scientific and medical equipment in response to the strong growth of Japanese capital spending in the 1984-85 period. But the country's waning competitiveness in labor-intensive products was also apparent in the import statistics, with the $0.9 billion rise to $3.9 billion in purchases of foreign-made textiles and apparel just the most dramatic example of this trend.

Domestic Economic Policy

During the 1984-85 period, the basic principles of postwar domestic policy were the subject of heated debate. Policies that had contributed to the economy's rapid growth throughout the three decades immediately after World War II had become roadblocks to further development and the source of major frictions with Japan's trading partners. Although Prime Minister Nakasone pushed vigorously for many of the changes, he did not initiate the reform process. Neither did foreign pressures lead to this rethinking, although external considerations certainly had an impact, particularly when it came to implementation. Instead, domestic forces had become aligned behind the need for change as the economy pulled abreast, if not ahead, of many of its Western competitors. It was these domestic voices that got the attention of policymakers. Their calls, however, were not always answered in the expected fashion.

Financial Liberalization

Domestic pressures for liberalization of financial markets had been building for many years due to the economic changes brought about by slower economic growth in the 1970s and early 1980s and the increasing internationalization of Japanese companies. Lower growth led to reduced capital investment by industry, which in turn meant that companies demanded less of the nation's savings. At the same time, however, the savings pool continued to grow as individuals and corporations continued their thrifty behavior.

The rapidly building reservoir of money put increasing pressure on the financial system. Individual and corporate investors were rapidly becoming more sophisticated and demanding higher returns on their assets, yet existing regulations kept most savings dammed up in Japan. This domestic pressure combined with external forces to encourage the Ministry of Finance to begin opening new outlets in the framework of financial regulations in 1985 — but only so slowly as to avoid "disruption" of financial markets.

The thrust of liberalization was two-fold. First, there were measures designed to increase the attractiveness of the yen to foreigners and expand its use in global commerce. These changes were prompted in part by Washington's late 1983-early 1984 campaign to win a commitment from Tokyo to "internationalize" the yen in order to raise its value against the dollar (see Part V). Second, Tokyo continued the process of reforming and deregulating domestic financial markets begun in the 1970s. This not only meant that Japanese providers of financial services have more freedom to offer new instruments and buyers could shop around for the best deal; it also meant that foreign financial actors were able to play a larger role in Japanese markets.

Although these two goals were quite distinct, policy changes often had an impact on both. Nevertheless, the distinction is useful in examining the events of the 1984 and 1985.

Yen Internationalization The basic thrust of yen internationalization was simple: increase the value of the yen by promoting its use as a transaction currency in trade, an investment currency by nonresidents and a reserve currency by foreign governments. In the past Japanese monetary authorities, like those in other countries, were concerned that extensive foreign holdings of their currency would reduce the government's control over the money supply and increase the variability of the exchange rate. But capital flows do not affect a country's monetary base unless the central bank intervenes in the foreign exchange market. And, in fact, the yen did experience wide swings in its exchange value even though it was less widely used internationally than other major currencies.

Although the share of the yen in global official foreign exchange reserves more than doubled from 2 percent in 1976 to 5.2 percent in 1984, this proportion was still small relative to the 65.1 percent figure for the dollar and the West German mark's 12 percent share. Moreover, given the size of Japan's economy and its exports and imports, the degree of trade denominated in yen remained surprisingly low. Only 3 percent of Japanese imports were valued in yen in the mid-1980s, while about 40 percent of the foreign purchases made by West Germany, the United Kingdom and France were denominated in local currencies. One reason for the limited trade use of the yen was that roughly three-fourths of Japan's imports are raw materials and these bulk commodities are generally priced in dollars worldwide. Another was that the absence of a bankers' acceptance market in Japan until 1985 and the quantitative controls that formerly restricted bank lending encouraged importers to obtain trade credits abroad.

To spur the internationalization of the yen, the Finance Ministry took steps during the 1984-85 period to encourage the growth of the Euroyen bond market, expand the ability of foreign companies to float bond issues in Japan and increase the volume of international lending in yen. It also created a yen-denominated bankers' acceptance market and dusted off a proposal for an offshore banking facility. These measures, which expedited the net outflow of capital from Japan while doing little to promote the use of the yen, are outlined below. Additional information can be found in Part V.

Euroyen Market Guided by the history of the development of the Eurodollar market, the Finance Ministry

targeted the creation of a relatively free European market for yen-denominated borrowing and lending. MOF felt that this move would be less disruptive domestically than some of the alternatives since it could insulate Japanese money markets from the action in Europe. Yet here, too, caution was the rule. The initial April 1984 qualification requirements for Japanese issuers of yen-denominated bonds — basically a double A rating — limited the number of eligible firms to just 90 or so. Even after this requirement was lowered to single A a year later, it still meant that only about 145 domestic corporations could take advantage of the new market.

Therefore, much of the Euroyen action came from foreign firms. Tokyo opened the Euroyen market to non-Japanese corporations in December 1984. (Until April of that year, when the most creditworthy domestic companies were authorized to tap the market, foreign governments and international financial institutions were the only issuers.) No restrictions were placed on the size or number of Euroyen bond issues by nonresidents. Moreover, any foreign bank or securities firm could serve as lead manager.

Foreign corporations moved quickly into the market, attracted partly by the relatively low yields Japanese underwriters were willing to accept. Margins were initially slight because Japanese firms wished to make a big splash and establish a presence in European financial circles. After a year, yields and margins began to rise toward levels seen in other European markets. Nevertheless, the Euroyen market remained attractive since it was free of many of the regulations and customs that hampered or delayed domestic bond issues.

As Tokyo continued the process of deregulation, these attractions grew to the point where some domestic bond markets became distinctly less favorable for foreign borrowers. In fact, the volume of Euroyen bonds exceeded *samurai* issues (yen-denominated bonds issued in Japan by nonresidents) in 1985, the first full year of liberalized activities, thanks in part to such June 1985 innovations as zero-coupon, floating-rate and dual-currency bonds.

The Euroyen market gave Japanese firms the chance to experiment with new instruments and gain valuable experience in international financial management. Whether it expanded the use of the yen was another matter. Many borrowers in the Euroyen market did not maintain the funds raised in yen; rather, they swapped the yen for another currency — a currency that would have been more expensive to raise in other markets. In short, there was no underlying real demand for yen for trade transactions, and financial demand was limited because Tokyo sought to prevent Euroyen from flowing back into Japan. Therefore, although the Euroyen market was successful in some respects, it did not really aid yen internationalization.

Access to Japan's Bond Market One of the most important measures in this area was the relaxation of rules covering *samurai* bonds, which were first introduced in 1979. In June 1984 Finance lowered the credit rating required for issuers, reduced the waiting period between issues and raised the permitted size of each issue. These changes led to a sharp increase in the volume of *samurai* bonds issued in 1985 to slightly more than ¥1.1 trillion, although, as mentioned, this figure was topped by ¥1.4 trillion in Euroyen bonds.

Overseas Financing In the 1982-83 period the Ministry of Finance set quantitative limits on overseas yen lending by Japanese banks because of worries about the Japanese currency's depreciation and the international debt crisis. In 1984, however, restrictions on the overall amount of lending and the accompanying country limits were abolished, leading to a substantial rise in foreign yen loans. A related step was taken in June 1985 when controls on yen-denominated syndicate loans to foreigners were eased. Lenders were allowed to link the loan's interest rate to the floating rate for certificates of deposit. This put Japan's 13 nationwide commercial banks on a par with the three long-term credit banks, promoting competition to the benefit of foreign borrowers.

Japanese banks made such a big splash in overseas markets in 1985 that MOF became concerned that overzealous competition among Japanese lenders could have negative reverberations at home. Therefore, May 1, 1985 guidelines included off-balance-sheet transactions for the first time while simultaneously abolishing or raising limits on particular activities. Among these were a ceiling of 14 times shareholders' equity on foreign liabilities; limits on high-risk loans that depended on the type of instrument; allowing lending by overseas subsidiaries to grow by 20 percent annually; elimination of the cap on lending or borrowing in foreign currencies; and more freedom to participate in international loan syndicates.

Another significant reform was the end to the ban on the sale of foreign commercial paper and CDs in April 1984. This step, originally planned for 1982, had been delayed to avoid depressing the yen through large capital outflows. In addition, regulations governing financial accounts held by residents abroad were eased, a move expected to contribute to the efficient use of Japan's savings surplus.

Bankers' Acceptances A market in yen-denominated bankers' acceptances, which are issued by exporters and importers in exchange for cash to underwrite trade transactions, opened in June 1985 with MOF setting the initial volume at ¥1.3 trillion and the minimum instrument size at ¥100 million. Domestic banks and discount brokers were allowed to deal in the new market, but to the chagrin of U.S. officials, foreign stock brokers with

Tokyo branches were not permitted into the market, although foreign banks were. (The ban extended as well to Japanese securities houses, which had planned to tie up with their American counterparts to enter the market.) Instruments traded on the new market included yen-denominated usance, accommodation and refinancing bills plus two types of corporate notes. MOF continued to study the entry of securities firms, whether foreign or domestic, into the market, but set no deadline for a decision.

This market was supposed to encourage banks to link short-term loan rates to market-determined interest rates. But increased demand for yen, a twin objective of the establishment of a BA market, was in no way guaranteed since traders can reverse their yen position in the foreign exchange market. Tokyo hoped, though, that increased use of the yen as a unit of account would increase the demand for yen as an asset. The failure of the bankers' acceptance market to live up to expectations in 1985's second half was attributable in part to the complex rules governing the market.

Offshore Banking Facility In late 1985 a Ministry of Finance advisory panel breathed new life into an old proposal: the creation of an offshore banking facility in Tokyo. Increased use of the yen in international transactions — the target of offshore banking activities — would contribute to the internationalization effort over the long term, argued the advisory group in outlining a market for accepting yen deposits and extending yen loans isolated from domestic financial markets.

Initially, foreign banks and Japanese foreign exchange banks would be allowed to participate in the market; securities firms would be excluded. All deposits and loans would be free of domestic reserve requirements, interest rate ceilings and, most importantly, any withholding tax. All funds would be kept in special accounts that would allow MOF to insure that there was no leakage into the domestic market, which would complicate the conduct of monetary policy. A minimum deposit would be required, mirroring the New York International Banking Facility's $100,000 minimum. MOF predicted that the new market would not only help broaden demand for the yen but also reduce the operating costs of Japanese financial institutions since some of their overseas business could be conducted from Tokyo.

Other Actions One initial step toward wider use of the yen was the removal of the "real demand rule" in April 1984 that limited foreign exchange transactions to those that covered specific real transactions. This change led to a large increase in foreign currency operations since purely speculative transactions became possible. In addition, restrictions on short-term Euroyen loans to Japanese residents were lifted in June 1984, producing a steady increase in the volume of such lending, while controls on Euroyen CDs of less than six months were relaxed in December of that year.

Legislation authorizing overseas bond issues ("Nakasone bonds") was passed in 1984; however, the new borrowing authority had not been used by the end of 1985. Overseas borrowing by government-affiliated agencies, though, contributed to efforts to raise the value of the yen. The Japan Development Bank, for example, issued $100 million of bonds in New York on two occasions in 1984 and another $200 million in November 1985.

Domestic Liberalization Until the mid-1980s Japan's financial markets were highly regulated and characterized by strict segmentation of institutions by function. There were banks that specialized in long-term credit; banks that made corporate finance their main concern; securities houses that performed investment functions; and various other institutions that were prohibited from competing across segments. This arrangement drew a great deal from the American situation, particularly the Glass-Steagall Act, which separates investment banking from commercial banking in the United States.

In order to meet the changing needs of Japanese corporations as well as to provide new growth opportunities for financial institutions, Tokyo began to move away from segmentation and strict regulation in the 1984-85 period. As always, caution and a step-by-step approach characterized Tokyo's actions. Foreign domination of Japan's markets was not the concern since domestic financial institutions already ranked high in global terms; chaos was. MOF did not want a free-for-all to ensue as it gave companies more freedom to compete. Although a shakeout seemed inevitable, regulators wanted to make the transition as painless as possible.

Deposit Rates The relaxation and eventual elimination of controls on interest rates paid on time deposits promised to bring sweeping changes to Japan's domestic financial markets. For one thing, it meant that Tokyo had to surrender one of its direct monetary policy tools. There was little doubt, moreover, that interest rate liberalization would put pressure on banks and other savings institutions while offering benefits to buyers of financial services. It was no wonder, therefore, that Tokyo moved ever so slowly to implement significant changes in this area.

While interest rates charged on loans between large entities had been determined by market forces for some time (the interbank and *gensaki* markets, for example), returns on time deposits remained strictly controlled. Small deposits, in particular, were a sensitive subject because the government's postal savings system accounts for nearly half of all deposits and is a main funding source for the Fiscal Investment and Loan Program. If deposit rates were freed,

government officials worried, then the postal savings system might lose many of its depositors to institutions offering higher rates.

To forestall this development while upholding its pledge to free interest rates on time deposits, the Finance Ministry opted for liberalizing rates paid on large deposits first; decontrolling small deposit rates was left for a vague future date. After much preparation, rates on new deposits of ¥1 billion or more were freed on October 1, 1985. With the minimum size set so high, it was not surprising that the change took some time to have a noticeable impact. Although large corporations immediately jumped at the chance to earn higher rates, it took smaller depositors some time before they realized that the higher returns outweighed the costs of consolidating many accounts into one.

CDs and MMCs Progress was also achieved in deregulating the CD market. The ceiling on the volume of CDs banks could offer was raised in several steps, the last coming in October 1985 when the cap was lifted to 200 percent of net worth from 150 percent. The minimum denomination of a certificate was also cut — first to ¥300 million in January 1984 from 1983's ¥500 million level and then to ¥100 million in April 1985. In addition, the minimum maturity was shortened in April 1985 from three months to one month, although the maximum term remained at six months. Finally, securities firms began trading these instruments in June 1985, joining the 13 nationwide commercial banks. This move, which further lowered the barriers separating the banking and securities industries, was expected to produce a significant expansion in the CD market.

A new instrument was introduced to the Japanese market in March 1985 — money market certificates. This innovation had been sought by banks, which were losing deposits to securities companies whose government bond mutual funds (*chukoku* funds) proved very popular and were therefore lobbying for a way to reverse the leakage. Sold in minimum units of ¥50 million, the rate of return on MMCs was pegged 0.75 percentage point below the CD rate. Since CD rates were market-determined, this meant that MMC rates would also rise and fall in line with the market's movements.

Government Bond Market The government also sought new ways in the mid-1980s to deal with its massive outstanding debt as the first bond issues began to mature. A short-term bond market (bonds with a maturity of less than a year) opened in April 1985, while the start of a government bond futures market in mid-October helped smooth out the debt rescheduling process. In order to lessen the impact of the new short-term bonds on bank time deposits, Tokyo decided to limit fiscal 1985's issues to ¥500 billion, set a high minimum unit (¥100 million) and prohibit securities firms from including the new bonds in their trust portfolios.

The number of banks allowed to buy and sell government bonds in the secondary market jumped to 87 from 37 on June 1, 1985. Six of the new entrants were foreign banks. They joined the three offshore banks authorized in mid-October 1984 to deal in outstanding government bonds. At the same time, MOF allowed bonds of all maturities except new issues to be freely traded. The high technology revolution also swept the government bond market on June 1 as electronic trading was instituted. The impact was dramatic: the volume traded on the first day alone (¥14.4 trillion) totaled nearly one-fifth of the overall volume in fiscal 1984 (¥75.7 trillion). This event was particularly encouraging in light of the interest of foreign companies in floating bonds in Japan.

Trust Banking Throughout the postwar period, MOF pursued the principle of separation and specialization of financial institutions. Two aspects of that policy are key to understanding the trust banking issue. First, securities transactions and banking operations were strictly separated. Only minor changes had been made prior to 1984 to blur this distinction. Second, through administrative guidance, MOF disconnected trust banking and ordinary banking in the 1950s. The result was that a number of banks split off their trust banking operations. By 1984 there were seven specialized trust banks, and only minor trust banking activity at one commercial bank.

While division of financial services was MOF's postwar watchword, domestic industry increasingly clamored for change. Along with the general process of deregulating interest rates and introducing new types of instruments, specialized institutions wanted to branch out from their traditional businesses. In particular, securities houses were anxious to get their hands on some of Japan's mushrooming pension funds — the investment of which was the prerogative of trust banks and insurance companies.

In an effort to enter this lucrative and rapidly expanding market, a number of securities firms signed preliminary agreements with foreign banks to set up trust banking joint ventures. Thus, the desire of American and European banks to penetrate Japan's financial markets became linked to domestic pressures for institutional changes. Trust banks and insurance companies tried their best to preserve their monopoly. Brokerage houses, though, had a fallback position. They complained that the government's April 1983 decision to allow commercial banks to sell government bonds over the counter infringed on one of their traditional activities and that they should be compensated in the form of access to the trust banking business. Finance Ministry officials retorted that fairness demanded that banks be given a chance to expand into a new market — trust

banking — as well. The ministry signaled its intent to blur this traditional barrier when it allowed the Japanese branch of Vickers daCosta Securities Ltd. to continue its trust activities even after it was acquired by Citicorp, which had a banking presence in Japan via its Citibank subsidiary.

When Tokyo initialed the yen-dollar accord in May 1984 (see Part V), it agreed to allow foreign banks, joint ventures between foreign and Japanese banks and the domestic branches of foreign banks to move into the trust banking market. The accord, however, contained a nasty surprise for Japan's Big Four brokerage houses and the four major U.S. banks with which they had tentatively tied up to manage trust funds: Japanese securities houses could not participate in the trust market through joint ventures with foreign firms.

Domestic commercial banks were more successful in their campaign to win access to the pension fund management business since MOF eventually decided to let eight banks reenter the market. Using this opening foreign bankers lobbied the ministry for equal treatment. Without making a firm commitment, finance officials intimated that eight foreign banks would also be authorized to engage in trust banking. When the deadline for applications arrived at the end of March 1985, however, the ministry had a problem on its hands: nine highly qualified foreign banks had applied for the targeted eight slots. All nine finally were approved, but it took some pressure from their governments.

Tokyo Stock Exchange Domestic and foreign interests also coincided on another issue: gaining seats on the Tokyo Stock Exchange, the world's second-largest equity market. Here, though, MOF could only run interference, not guarantee results, since the TSE is a private organization. But prodded by the government, the exchange announced in late August 1985 that it would increase its membership by 10 seats to 93. This move was implemented three months later when the TSE selected six of the ten foreign brokerage houses that had applied for full membership to fill the newly created seats, with the others going to four of the eight domestic firms submitting applications.

Outlook Japan's financial system changed significantly in the mid-1980s as a result of continued market deregulation, the creation of new instruments and the entry of additional players, both foreign and domestic. Without doubt liberalization made Tokyo an increasingly important international financial center. Its impact on the internationalization of the yen was questionable, but this uncertainty was not surprising since stepped-up use of the yen in trade and as an investment and reserve currency depended at least as much, if not more, on the decisions of traders, investors and foreign governments as it did on action by Tokyo.

Despite the changes initiated in the 1984-85 period, domestic and foreign interests alike continued to press the government to lift the large number of remaining controls. Finance ministry officals repeatedly pledged to proceed with liberalization, but Tokyo's timetable was so drawn out that it was unlikely to quiet critics at home or abroad.

Tax Reform

Just as in the United States, tax reform in Japan was an often debated but rarely implemented idea. By the end of 1985, however, real movement had been made toward forming a consensus among political elites on how to begin the process. Several factors led to this development. Fiscal austerity was placing increasing demands on the existing tax system at a time when public dissatisfaction with the tax laws was growing. Moreover, business groups repeatedly complained that the international competitiveness of Japanese industry was threatened by corporate tax rates significantly higher than those in other industrial nations, including this country. Finally, the United States appeared to be on the verge of enacting a major tax reform bill, providing a model to study.

Major Targets The points of contention were numerous; however, a handful received the greatest attention: the tax-exempt small savings system; personal income tax regulations; and the introduction of a major indirect tax.

Tax-Exempt Savings System Reforming the tax-free savings system for individuals, or *maruyu* savings as it is commonly called, remained a sensitive subject in the mid-1980s. MOF proposed several possible reforms to control abuses of these accounts and increase revenue by cracking down on unreported interest income. The Ministry of Posts and Telecommunications, which administers the postal savings system — a major beneficiary of *maruyu* savings, opposed the MOF reforms, however.

The tax-free savings system played an important role in providing funds for the country's economic growth, but the system had always lent itself to abuse. Interest income on individual deposits of up to ¥3 million is tax-exempt, and reporting requirements are minimal (for bank deposits) or nonexistent (for postal savings accounts). This lack of accountability led people to open illegal multiple accounts under false names to avoid paying taxes.

MOF officials estimated that over ¥226 trillion was held in tax-exempt accounts in FY 1982, equivalent to nearly 60 percent of total individual savings. The National Tax Administration claimed to have uncovered more than ¥670 billion in illegal *maruyu* accounts, fining multiple account holders a total of ¥20 billion. While there were no specific figures on the total amount of tax-dodging, MOF calculated

that the entire tax-exempt savings system cost the government ¥2 to ¥3 trillion a year in foregone revenue.

In the fall of 1984 Finance Minister Noburo Takeshita suggested five possible routes to reforming the system: tightening existing controls on the maximum allowable amount of tax-free savings through computerization of reporting or setting a reporting deadline; introducing savings registration cards (green cards) to eliminate multiple accounts and requiring savings institutions to validate the identity of depositors; setting a ceiling on the amount of interest considered tax-free instead of on the amount of capital; levying a low tax (10 percent was suggested) on all tax-free savings; or abolishing the system altogether.

Posts and Telecommunications Minister Ketwa Okuda strongly rejected any meddling with the postal savings system, claiming that support for the system was universal and that modernization plans already in motion would reduce abuses. In particular, he argued that as MPT installed a nationwide automatic teller network, a de facto green card system would develop, making tax avoidance much more difficult.

This was not the first time that reforms had been proposed. As part of the FY 1980 tax bill, the green card registration system was mandated along with a progressive tax on interest income earned on deposits over ¥3 million. The green card was to go into effect on January 1, 1984. A political debacle developed as the day of reckoning approached. Depositors began to shift money around to evade taxes, opposition parties championed repeal of the reforms, and the government poured money into preparing for a system that would never be implemented.

This time, however, more factors weighed in favor of reform. Liberalization of financial markets altered the viewpoint of private institutions courting small depositors. The ability to offer attractive instruments to small savers prodded the financial industry to lobby for reforms that would divert funds in their direction. Many public and private reports emphasized the need to utilize the country's financial resources more efficiently; one way to do this would be to reduce the amount of money going into MPT's postal savings system. Finally, amid growing concern about the size of the national debt, many observers called on politicians to bite the bullet and rein in tax-free deposits.

By the end of 1984 two plans had emerged from inter-ministerial discussions. The first option would mandate strict enforcement of existing rules by savings institutions to reduce abuses while preserving the tax-free savings incentive. Budget writers, however, favored the second proposal, which would eliminate the tax exemption altogether in exchange for a flat 5 to 10 percent tax on interest income. They contended that this would totally eliminate tax evasion, maintain progressive taxation principles and raise a hefty ¥1.5 trillion in revenue to boot. Banks called both plans unacceptable, while MPT rejected the second alternative, arguing that it would widen the tax system's inequalities. Although no action was taken in 1985, this debate prepared the foundation for progress in 1986.

Income Taxes Well before the mid-1980s the majority of the population considered the income tax system unfair, not because of skewed statutory rates but because of non-uniform collection methods. Taxes are deducted from salaried workers' wages by the employer, insuring full compliance. For self-employed people and farmers, who still account for a major portion of the workforce, a system of voluntary income reporting and self-tax assessment is the law. It was therefore no wonder that tax avoidance was low among the first group but high among the second. According to some crude calculations, 90 percent of the income of salaried workers is subject to taxation compared to 60 percent for those who are self-employed and only 40 percent of farmers' income.

To complicate matters, individuals as well as corporations felt over-taxed by international standards. According to the National Tax Administration, earnings from wages rose 5.2 percent in 1983 while taxes paid increased 6.6 percent. Despite a decline in the growth of taxes from the 10 percent rate of 1981 and 1982, middle-income earners paid noticeably higher taxes in the mid-1980s. Corporations, moreover, were campaigning for better tax treatment, arguing that present rates jeopardized their international competitiveness. Business, however, was not innocent when it came to tax evasion. According to MOF, under-reporting by corporations with foreign subsidiaries totaled ¥3.4 billion in fiscal 1983 and ¥12.1 billion in fiscal 1984. The swelling of popular discontent in 1985, it turned out, would power the drive for reform the following year.

New Indirect Tax An increasing number of people, including Prime Minister Nakasone and Finance Minister Takeshita, saw a solution to the pressure for major tax reform and the demands of deficit reduction in the introduction of a large indirect tax modeled after the value-added tax levied by European countries. A tax collected at every stage of the production process had the advantage of raising a large amount of revenue; at the same time, though, it would impose a larger administrative burden on manufacturers and might not result in progressive effective tax rates. To balance the increase in prices that would almost certainly result from a VAT, the Finance Ministry proposed reductions in both individual and corporate tax rates as well as uniform reporting and collection methods.

The government initiated a one-year study of a VAT system in early 1985, hoping to begin making major changes in FY 1986. LDP leaders, while acknowledging the

possible need to increase indirect taxation to reduce the budget deficit, moved very cautiously on the VAT idea. With upper house elections already scheduled for the summer of 1986 and a good chance that double elections would be held, party officials were anxious to avoid a repeat of the severe blow the LDP received in the October 1979 lower house elections because of negative popular reaction to a proposal to introduce a value-added tax. A broad VAT remained attractive, however, since increased direct taxes were politically out of the question and higher or expanded commodity taxes — the main indirect tax alternative — would be difficult to administer and would have an uneven impact on taxpayers.

Reform Studied Mr. Nakasone, contemplating his chances of gaining a third term as prime minister, pushed for the introduction of some tax reforms in fiscal 1986. As a first step he inaugurated the Government Tax System Advisory Council on September 21, 1985. The advisory body of business and government officials was given a mandate to explore various options against a background of fiscal conservatism and international trade friction. The reform package was expected to include both tax reductions and increases — the latter to meet the austerity criterion and the former to enhance domestic demand and, in the process, reduce trade tensions.

Four principles were to guide the council's work: equality of taxation; fairness of tax rates; economic development; and economic opportunity for individuals and businesses. On the agenda were the following topics and the actions proposed by the Finance Ministry during the FY 1986 budget process in the fall of 1985:

Personal Income Taxes Under the rubric of equality and fairness, the Ministry of Finance had proposed that the tax rate in the top personal income tax bracket be reduced from 70 percent to 60 percent. At the same time, the number of brackets would be reduced from 15 to 10. Mr. Nakasone and other LDP officials, however, sought across-the-board rate reductions and an even greater cut in the number of brackets.

Corporate Income Taxes In addition to continuing some temporary measures introduced in fiscal 1985, such as a 1.3 percent surcharge on corporate income, MOF wanted to lower tax-free bad debt reserve requirements and place new taxes on financial institutions and small businesses. Simultaneously, though, the ministry indicated it was leaning toward a cut in the statutory corporate tax rate from the current 43.3 percent level, perhaps to the 33 percent maximum then being discussed in the United States. Finance officials also leaked word that they were examining the possibility of accelerating depreciation schedules or shortening the useful lives of capital goods beginning in fiscal 1987.

Indirect Taxes [illegible]roduction of a new large-scale indirect tax was expe[illegible]e the most politically sensitive issue tackled by the council. In fact, the advisory group's mandate contained explicit reference to the LDP's disastrous showing in the 1979 elections after it floated the idea of a value-added tax. For this reason recommendations on the indirect tax question were to be released after the 1986 elections. In the meantime, though, increases in liquor and commodity taxes were proposed for FY 1986.

Taxes on Interest and Dividends Under the council's guidelines, the trade-off for income tax cuts was the elimination of tax-free savings accounts. If all went well, a 5 to 10 percent tax on all interest and dividend payments would be in place by fiscal 1987. Resistance from LDP members and officials of the postal savings system to the proposed repeal of the tax-exempt system was expected to be fierce, however.

Other Taxes The home buyer credit, household energy conservation tax credit and computer/robot small business tax credit, all slated to expire in FY 1986, were to be extended for one year. To further promote residential construction, it was proposed that the mortgage deduction be increased from 18 percent to 25 percent of the amount of the mortgage that exceeded ¥3 million and that the deduction ceiling be raised from ¥1.5 million to ¥3 million. The council was also asked to explore the prospects for reform of Tokyo's revenue-sharing program with local governments. In FY 1984 32 percent of the national government's revenue from personal income, corporate and liquor taxes had been transferred to local governments, putting added strain on general account budget funding.

In short, prospects for significant tax reform were bright at the end of 1985 as a national consensus finally began to take shape. The government had initiated the lengthy reform process and the cabinet was doing its best to encourage movement. Momentum was lost in 1986, however, as new obstacles were encountered.

Privatization and Deregulation

Prime Minister Nakasone came to office in 1982 intent on making fiscal reconstruction one of the hallmarks of his tenure. A key part of this process was administrative reform — the idea that a more efficient government would trim budget expenditures. Among the primary targets of the movement were three huge public corporations — Nippon Telegraph and Telephone Public Corp., Japan Tobacco and Salt Public Corp. and the Japanese National Railways.

In its final 1983 report to the prime minister, the ad hoc Commission on Administrative Reform had proposed reorganizing the trio into semi-private operations or companies that would be privately managed but whose stock

would be held by the government and Japanese investors. Mr. Nakasone quickly made implementation of this recommendation one of his top priorities, outlining an ambitious timetable for what came to be known as privatization. NTT and JTS were to be reorganized by April 1, 1985 and the transformation of JNR would follow two years later.

Drafting the legislative packages that would privatize the Japanese giants that dominated railroad operations and monopolized the domestic markets for telecommunications equipment and services and tobacco products took government policymakers into uncharted territory. So did their task of working out measures to open the communications and cigarette businesses to competition. The only guideline they had was that privatization should spawn viable ventures. To this end, it was proposed that NTT and JTS retain many of their assets, thereby assuring them of a strong position in the deregulated market. In exchange, though, the draft legislation required them to maintain certain unprofitable operations.

Keeping to his timetable, the prime minister won Diet approval for the reorganization of JTS and NTT in 1984 after modifications sought by opposition parties as well as the U.S. government were incorporated. In both cases, the newly privatized corporation would remain the dominant player in its market. Foreign and domestic access to the market, however, was greatly expanded. The Nakasone administration could therefore claim victory in this part of the administrative reform drive, at least on paper.

NTT In a move that would eventually change the entire cast of Japan's domestic telecommunications market, the Ministry of Posts and Telecommunications unveiled proposals in early 1984 to reorganize NTT into a semi-private company and break its monopoly on equipment and services. The reorganization draft generated a mixed response both in Japan and abroad. Proponents argued that NTT's management must be streamlined and the company's sights set on promoting technical innovation and moving into fast-growing markets. Because NTT's primary market — voice telephone service — was near saturation, this area offered limited possibilities for technical innovation and growth, it was argued. Therefore, if NTT's vast financial, human and technical resources were to be fully utilized, it had to have the freedom to enter new areas.

Opponents agreed that competition would be beneficial, but criticized the MPT proposal as being anti- not pro-competitive. NTT would be allowed to spin off equipment and service companies — a flexibility critics feared would create a closely linked group of firms dominant in their fields. Opponents also worried initially that NTT would be able to dump its less profitable local telephone operations, degrading national service, although concern over this point receded after the government indicated that the privatized NTT would be required to provide a minimum level of nationwide service.

Far more controversial than the reorganization outline was MPT's deregulation proposal. The draft legislation divided market participants into two groups. Type I businesses would own and operate their own communications networks; in short, they would be common carriers like NTT. Permission to enter this field would be granted on a case-by-case basis, although in principle firms with foreign ownership ratios exceeding one-third would be barred. All other market entrants would be classified as Type II businesses or companies leasing circuits from a common carrier and providing enhanced or value-added services. This group was to be further divided into Special Type IIs and General Type IIs depending on whether the company provided nationwide services or offered more specialized local or regional services. Like common carriers, Special Type IIs would need an MPT license to operate. In principle, these firms could have up to 50 percent foreign ownership, although decisions again would be made on an individual basis. No license, however, would be required for General Type IIs. Moreover, there would be no restrictions on foreign ownership.

This version of MPT's deregulation proposal was actually less restrictive on the question of foreign participation in the secondary services market than the initial one. When the ministry first considered the matter in late 1983, it proposed limiting foreign ownership in Type II businesses to just 20 percent. This plan not only aroused the concern of potential foreign competitors, which hoped to capitalize on their technology and experience with enhanced or value-added services to establish a significant presence in the world's second-largest telecommunications market. It also prodded the Ministry of International Trade and Industry into action. A MITI advisory group took issue with the MPT draft on three points. First, while it agreed that unrestricted competition was not appropriate for primary services such as voice telephone service, the panel argued that free access was the right move for secondary services such as value-added networks. It was also maintained that MPT's intention to regulate Special Type II companies through licensing and to separate them from General Type IIs was not suited to the nature of the industry. Finally, the advisory body stated, MPT's deregulation plan would weaken, not strengthen, the competitive abilities of Japanese companies in an industry central to the country's economic future.

A tough inter-ministry battle ensued over deregulation, with MPT seeking to retain controls while MITI sought their elimination. In addition, the reorganized NTT's potential to dominate the deregulated market also served as a flash point for domestic debate. The internal government fight over reform of the telecommunications market was so

intense that the original March 27, 1984 deadline for reaching a consensus was pushed back. In typically Japanese fashion, the matter was referred to as "a political decision," and a Liberal Democratic Party advisory board was asked to mediate. Setting a new deadline of March 30, the board held numerous meetings and hearings with government, industry and foreign officials in an attempt to overcome the main obstacle: MPT's continued insistence that Special Type II businesses should be subject to licensing.

The compromise proposal that broke the deadlock called for the establishment of a simple registration/notification system for secondary services businesses. Companies interested in offering Special Type II services would have to register with MPT but could begin operations 20 days after filing an application; firms providing General Type II services only had to notify the ministry of their activities and could start business immediately. This solution, it was hoped, would satisfy everyone's needs. While it did not say so publicly, MPT was afraid that a complete lack of control would lead to unbridled competition and possible foreign domination of the secondary services market.

In addition to this reporting requirement, the compromise proposal contained four other provisions. New common carriers would have to be licensed by MPT and could be no more than one-third foreign owned. At the same time, no limits would be placed on the foreign ownership of businesses in the secondary services market, whether General Type IIs or Special Types IIs. As for NTT, it would become a semi-private corporation April 1, 1985. Up to two-thirds of the new organization's stock would eventually be offered on the open market for purchase by Japanese investors, with the remaining one-third held by the government. In addition, the new NTT would be limited to providing services and would not be allowed to have a telecommunications equipment manufacturing division.

Despite these restrictions, it appeared that NTT would gain significant independence from the government after being privatized. It would be allowed to work out revenue and expenditure plans without government approval, enter the telecommunications peripherals business and offer VAN services. On the other hand, NTT would not be allowed to let telephone service in unprofitable areas lapse, and it would be required to adhere to the procurement accord with the United States that was extended for another three years in January 1984 (see Part V).

However reluctantly, MPT and MITI accepted the compromise proposal, allowing the three-bill privatization and deregulation package to be approved by the cabinet in April 1984 and submitted to the Diet. After languishing in a legislative logjam caused by an impasse over health insurance reform, the legislation passed the lower chamber of the Diet on July 20. The bills then moved to the upper house for approval — a problematic point since that body was mired in the same health insurance debate that clogged the lower house's docket. Nonetheless, Prime Minister Nakasone tried to push for upper house approval before the August 8 adjournment. His efforts were foiled, however, when the Diet session ended without upper house action on the three-bill package.

Time ran out in part because of controversy over three provisions: the right to strike the reorganized NTT; government control over service rates; and the scope of NTT's operations. Opposition parties were concerned that the freedom granted NTT to set revenue and expenditure plans would lead to uncontrolled charges for basic telephone service. While the reforms were generally expected to lead to lower rates, fears that NTT would charge different rates in different areas according to profit-cost considerations prompted a compromise by the LDP and its coalition partner, the New Liberal Club, that would subject basic charges to government regulation while leaving others to NTT's discretion.

The main problem, however, was the elimination of employees' right to strike NTT — a provision the Japan Socialist Party, the main representative of the NTT labor union — pressed to have repealed. The LDP had originally included this prohibition because it was concerned that a strike after reorganization could prevent NTT from providing basic telephone services. The JSP would not back down on this point, and the two eventually agreed to review the ban after three years, hinting strongly that it would be lifted. In exchange, the JSP did not object to allowing NTT to enter several secondary markets.

The prime minister was faced with two alternatives when the telecommunications reform bills failed to pass: he could call another special session in October to secure passage before the LDP presidential elections in November, or he could wait until after the elections and use his new mandate to win approval. While he initially leaned toward the first alternative, advisers persuaded him to adopt the second option, arguing that a special session could get out of his control and embarrass him immediately before the party polling.

As promised, the Diet put the package of telecommunications reform bills at the top of its agenda for the new December 1984 session. The House of Councillors passed the legislation December 14. As is the case in the United States, the lower house had to reapprove the bills since the Diet had begun a new session. The House of Representatives voted on the issue December 20, passing the package handily. This milestone marked the end of the domestic debate over the reorganization of NTT and deregulation of the domestic market for telecommunications

equipment and services. Unfortunately, it did not bring an end to international frictions. Japan and the United States would continue to hold tense negotiations throughout 1985 — a subject covered in Part V.

JTS The tobacco products market was targeted for reform for basically the same reason the telecommunications equipment and services market was on the list: to reduce the role of government in the market, increase foreign access and improve consumer service. Japan Tobacco and Salt held a monopoly on the production and distribution of cigarettes, cigars and pipe tobacco. The public corporation also controlled imports and distribution of foreign tobacco products, which it marketed through a small percentage of the total number of Japanese retail outlets. The biggest problem for overseas suppliers, though, was the government-determined pricing formula, which produced a ¥100 to ¥160 differential between a pack of imported cigarettes and the comparable domestic product, despite the fact that the landed price of foreign cigarettes was no higher than the ex-factory price of Japanese brands.

In early April 1984 the cabinet adopted a proposal to transform JTS into a semi-private corporation effective April 1, 1985. Like the new NTT, the reorganized tobacco products company was to be wholly owned by the government for several years, although officials did envision selling off as much as one-third of its stock to Japanese investors at some future time. But unlike the revamped NTT, the renamed Japan Tobacco Inc. would retain many of the powers JTS exercised. It would still be required to buy all of the domestic leaf crop; it would continue to monopolize production of cigarettes, cigars and pipe tobacco; and it would control the distribution of domestic tobacco products.

The most significant change contained in the draft legislation was the provision opening the import and wholesale business to foreign companies and domestic firms alike. Once they registered with the Ministry of Finance, these potential distributors would be able to sell directly to Japanese retailers. In addition, the Ministry of Finance would no longer have to license retail outlets before they could carry foreign cigarettes and other tobacco products.

The biggest question mark about the proposed legislative package from an international standpoint concerned the pricing of imported tobacco products after April 1, 1985. On paper, the draft looked promising. Foreign suppliers would be able to set their own retail prices as long as they took into account the relevant tariffs and excise taxes and they could apply directly to MOF for price approval. Moreover, the government endorsed changes in the pricing formula that it argued would favor imported cigarettes. Overseas manufacturers, however, reserved judgment on this part of the package.

This reaction indirectly highlighted the fact that the JTS legislation adopted by the cabinet differed significantly from the recommendations forwarded by the Commission on Administrative Reform, which would have restructured JTS along the lines of NTT or Japan Air Lines Co., Ltd. In short, the advisory group suggested relegating government control to a backseat position, encouraging private management practices and, most importantly, breaking JTS's monopoly on the production and distribution of domestic products. Strong pressure from Japanese tobacco growers and a resistant JTS bureaucracy stymied any efforts to really liberalize the system, however. Moreover, a new export corporation was in the works as a result of lobbying by growers who wanted to expand into new markets to alleviate the stagnant demand at home.

Because the new company was required to purchase the entire domestic crop, Japanese tobacco growers did not voice much opposition to the reform package endorsed by the cabinet. JTS's management, while worried about foreign sales inroads, was satisfied with its relatively strong position. The only real domestic opposition to the changes came from anti-smoking groups, but they did not have the clout to influence the outcome of the legislative proceedings. The reform legislation therefore cleared both houses of the Diet in quick order in July and August 1984.

While foreign cigarette manufacturers were reassessing their Japanese sales strategies and trade policymakers in Washington were trying to figure out whether the reform movement had really liberalized the market (see Part V), JTI's management was busy restructuring the company to meet the challenge of foreign competition. JTI was organized into six divisions with increased emphasis on research and development, marketing and sales promotion. Customer service was also upgraded with date-of-manufacture stamps on product packages as well as a network of "customer relations facilities." The clearest example of management emphasis on improving JTI's competitive muscle, though, was the plan to cut employment by 2,300 and reduce the number of branches from 310 to 155 by 1988.

JNR More difficult than the reorganization of NTT and JTS was the effort to force the Japanese National Railways out into the competitive world. Unlike the other two public corporations, JNR was financially weak. The rail company could not survive if it were simply privatized in its existing form. Everyone realized that employees and track miles would have to be reduced. The question was who, how much and how fast. JNR's management, its labor union, the Ministry of Transportation and others all had their own answers.

JNR's management began developing its reorganization proposal in the summer of 1984 and submitted it to the JNR

Reconstruction Management Council in early January 1985. Under this plan the system would remain a single entity but significantly smaller. Except for 20 metropolitan feeder lines, all local lines would be replaced by bus services run by JNR subsidiaries or local governments. Service on the islands of Hokkaido in the north and Shikoku in the south would be split off into separate private companies by 1990 since these lines were unlikely ever to be profitable. Freight operations would also be reduced 20 percent. These changes would leave JNR with 87 lines totaling 7,440 miles of track. Staff would be cut by 40 percent to 188,000 by transferring personnel to new JNR subsidiaries. Like JTI and NTT, the new JNR stock would be held by the government until profitability was attained, perhaps as early as 1990. In order for the proposal to work, Tokyo would have to provide subsidies for the Hokkaido and Shikoku areas as well as shoulder two-thirds of JNR's huge long-term debt.

The National Railway Workers Union (Kokuro) responded with its own, much more vague rehabilitation scheme. The union also wanted JNR to remain a single national entity. The government would have to cover 90 percent of JNR's accumulated deficit and provide big subsidies each year to maintain unprofitable local lines. At the same time, the union agreed that the hiring freeze then in effect should continue but argued for drastic cuts in supervisory personnel. The major thrust of its reorganization plan was diversification based on JNR's extensive real estate holdings.

In June 1985 the JNR Reconstruction Management Council, which was appointed by Prime Minister Nakasone in June 1983 to map out a rehabilitation plan, issued its final report. The advisory council recommended splitting JNR into at least 24 companies: one or more Shinkansen (bullet train) firms, one or more freight services, six local passenger service operations, 13 local bus companies, a telecommunications business and a research organization. Citing the influence of the Diet on route and personnel decisions as a major source of inefficiency in JNR operations, the recommendations called for all of the new companies to be privately managed.

Local rail passenger services would be divided among Higashi Nihon Kaisha (eastern Honshu), Tokai Kaisha (central Honshu), Nishi Nihon Kaisha (western Honshu), and one company each for the smaller islands of Hokkaido, Kyushu and Shikoku. A separate firm would own all the bullet train lines, which would be leased to the six local firms. JNR's cargo operations would be taken over by one company, its budding telecommunications operations by another and its two research institutes would be merged into a third firm. Local bus lines would initially be operated by the six regional companies but eventually would be spun off into 13 independent operations. Any remaining operations would be handled by a new firm, dubbed the "old JNR."

The committee estimated that when the reorganization took place on April 1, 1987, the new operations would require a labor force of 158,000 — 93,000 less than JNR's 1985 staff. To deal with the surplus, the advisory body recommended that 20,000 employees seek early retirement, 32,000 workers be given jobs with JNR offshoots, and the remaining 41,000 be placed in positions with public or private firms over a three-year period.

The new rail companies would owe the staggering total of ¥37.7 trillion on their first operating day, including ¥25.4 trillion in long-term debt, ¥4.9 trillion in pension obligations and ¥5.2 trillion for construction of new bullet train lines. In order to make the reorganization feasible, taxpayers would be forced to cover ¥16.7 trillion of the debt, while the new rail companies would have to cover ¥11.4 trillion and the "old JNR" ¥9.6 trillion.

The plan immediately drew criticism from a wide range of sources. Kokuro attacked the plan as a threat to the living standards of its 220,000 members. The Doro, or National Railway Motive Power Union, belittled the plan as too abstract. Indeed, the continued existence of both unions would be impossible under the reorganization: a host of smaller company unions would replace them. Other observers predicted managerial problems because 102 Shinkansen, 141 express and 179 local runs cross at least one of the proposed regional divisions. Furthermore, 26 lines would be subject to the control of three or more regional firms. The advisory committee report did not address the question of how this would affect ticketing and the quality of service.

To complicate matters further, some analysts warned that with the proposed breakup, heavily used urban lines would no longer subsidize less popular rural lines. This would be a serious blow to localities where there was no alternative transportation. The prospect of replacing railways with buses also elicited a hostile response from many communities. Finally, there were questions about adapting JNR's security force to the multi-company structure.

As 1985 drew to a close, therefore, the outline of a privatized national railway system had been roughed in but numerous details were still missing. Filling in these blanks would prove far more difficult for the government than reaching a consensus on how to reform NTT or JTS. Any decision affecting service or employment had potentially far-reaching local consequences — a situation tailor-made for political deadlock.

Structural Reform

In a potentially far-reaching move that received scant attention at the time, Prime Minister Nakasone established an advisory committee in the fall of 1985 to report on policies Japan should pursue to harmonize its economic

relations with other countries. The 17-member panel, chaired by former Bank of Japan governor Haruo Maekawa, consisted of academic, business and government leaders. The committee hoped to work out specific policy proposals by March 1986.

At its first meeting October 31 Mr. Nakasone stressed the importance of domestic demand-led growth. The prime minister reminded the panel that Japan's economic structure had received a great deal of international criticism, particularly from the United States. He expressed determination to modify economic policies covering interest rates, savings and capital transactions and to change the import structure and the distribution system in order to reduce frictions with trading partners.

Since monetary policy was handcuffed by exchange rate considerations and Mr. Nakasone remained committed to his policy of reducing the budget deficit, this left administrative reform, including deregulation, and perhaps tax reform as tools to stimulate the economy. Although these could have a major impact on growth, the Maekawa commission set itself a higher goal: the restructuring of the economy to focus on domestic demand. This was certainly the ultimate answer to relieving the country's dependence on exports for a major part of growth, but the task was equally daunting. Nevertheless, the prime minister put himself behind the group, whose report was to cause a major stir in 1986.

Protection of Intellectual Property

Given the emphasis on high technology by both the United States and Japan, it was no wonder that protection of intellectual property received a great deal of attention in the 1984-85 period. Lawmakers have continually found themselves lagging far behind the rapid advance of technology, and the legal framework is often unclear or silent on how to treat many disputes over intellectual property. Policymakers in effect have defaulted to the decisions of courts and bureaucracies, particulary patent and copyright agencies. Although some international intellectual property organizations are attempting to promote uniform policies around the world, disputes over conflicting laws are inevitable.

Software The opening salvo in the Japanese debate over how to protect computer software programs was fired December 9, 1983 by the Ministry of International Trade and Industry. A MITI advisory council proposed a completely new legal domain for software. The plan would offer 15 years of protection to a developer who registered a program by providing a complete listing that would be kept private and a summary of functions that would be made public. To protect software users, it was proposed that the ministry make available documentation covering important aspects of the program, force vendors to clearly describe the functions of the program, and establish a procedure to handle complaints about registered software. As for third-party rights, the advisory group recommended that copying, leasing and modification of the software be allowed for a reasonable fee without prejudice to the developer's fundamental rights. In the event that the developer was an employee of a corporation, the recommendation left open for clarification to whom these basic rights reverted. Finally, to assist in handling disputes, a penal code covering software was to be worked out, with MITI appointing a special judge to handle the actual proceedings.

Spurring MITI's move was the fact that there were 44 software cases pending in court, 20 of which had been filed in 1983 alone. Perhaps more importantly, MITI hoped to get a jump on the Ministry of Education. MOE, which has jurisdiction over copyright laws, had announced in late 1983 that it would study the question of how to protect software and issue a report in early 1984.

The release of the MITI report sparked a lively debate. Since the advisory group was advocating a legal regime it considered different from existing patent or copyright laws, even MITI was unclear about how the proposal would work. Most Japanese observers agreed that 15 years was rather a short period of protection and would not really provide adequate safeguards for software developers, especially designers of key programs such as operating systems. This, they argued, might inhibit investment in software development. MITI, however, placed great emphasis on the interoperability of future computer systems and felt that short-term protection would promote a wider diffusion of popular software at lower costs.

The Ministry of Education fired back at MITI in late January 1984 with an advisory council recommendation that Japan's Copyright Law be amended to give computer programs the same protection accorded literary works. The two proposals differed on three points. First, the period of protection varied greatly: MITI's 15 years versus MOE's 50 years. MITI argued for the shorter period on the grounds that software evolves very rapidly and the author should be able to recoup his development costs within this time. In contrast, MOE sought 50 years of coverage, holding that basic programs remain unchanged and must be protected throughout their lifetimes. Second, while applicants would have to submit a copy of their program under MOE's proposal, it would remain confidential information. The MITI proposal, on the other hand, required not only that a complete copy of the software be registered but that the author divulge how the program worked. Finally, copyrighting software would be voluntary under the Education proposal, but MITI would make participation in its system mandatory.

The tug-of-war intensified as opponents made final efforts to work up a compromise bill before the March 27, 1984

deadline for submitting non-budgetary bills to the Diet. MITI could not afford to acquiesce to the idea that software fell under the Copyright Law's domain and therefore was indeed intellectual and not industrial property since this would imply a lack of jurisdiction over the critical software industry. On the other hand, its proposal faced strong negative reaction from abroad. The Education Ministry, normally a lightweight in the bureaucratic ring, was a formidable opponent in this case. It emphasized the legal aspects of the issue — that international practice and treaties all lined up behind its copyright protection scheme — and carefully avoided the international trade aspects that were the primary concern of the United States (see Part V). Japanese industry representatives were divided on the issue, although most supported MITI.

The Ministry of Education prevailed in the end, which came a year later than initially expected. In early April 1985 the cabinet approved amendments to the Copyright Law proposed by the Agency for Cultural Affairs, an arm of MOE. The amendments provided program authors rights similar to those granted U.S. programmers, including 50 years of protection. Moreover, there was no provision for compulsory licensing. In a bow to MITI's position, however, the draft legislation provided that software users could alter a program to meet individual needs and that copies for individual use could be made without the permission of the copyright holder.

Two months later Japan quietly ended one of most heated issues in the U.S.-Japan relationship of the mid-1980s when both houses of the Diet approved legislation amending Japan's Copyright Law to explicitly include computer programs. The early June vote brought Japan's legal regime for protecting software into line with international standards and was expected to enhance the already booming global software trade.

Integrated Circuit Designs In late September 1984 MITI announced that it planned to submit legislation to protect the designs of integrated circuits to the Diet session that started in December. This move followed action in the United States on microchip protection. The bill signed into law by President Reagan established a new legal domain separate from traditional copyright law to protect IC designs, providing 10 years of coverage to designs registered or exploited after January 1, 1983.

MITI officials had closely tracked the American legislation and suggested that passage of the bill led to consideration of a Japanese equivalent. Spokesmen admitted, though, that the government was concerned about the potential for bilateral friction over microchip designs as competition intensified. The U.S. law's articles covering the extension of protection to foreign companies operating in the United States also prodded Japan and other countries to begin serious consideration of such legislation. Moreover, Japanese electronics firms, like their American counterparts, faced the prospect of piracy since they were turning out original designs.

The draft legislation recommended by a MITI advisory group in January 1985 outlined a new legal regime that would provide 10 years of protection to chip designers. Only designs would be protected, not the ideas they embodied. In another parallel to the U.S. bill, the study of protected designs (reverse engineering) would be allowed to promote competition. Differences between the Japanese and American versions did exist, however, particularly in the areas of design-right recognition and administrative procedures. While the American law charged the U.S. Copyright Office with administering the program, MITI staked its jurisdictional claim in this field.

Rumblings from MITI about similarities between the U.S. microchip bill and MITI's software proposal raised eyebrows on both sides of the Pacific. This country's legislation made it clear that an IC design was not a work of authorship — it was not a "book." The same could not be said of a computer program, however. The Ministry of Education might have contested MITI's bid for control over microchip designs, but unlike the software situation, the U.S. precedent worked against MOE, fatally weakening any resistance it might have put up.

Unlike the software protection issue, frictions were avoided over protection for IC designs, thereby insuring relatively quick action. In mid-March 1985 the cabinet accepted MITI's legislative proposal and the lower house passed it a month later, followed by upper house approval in late May. The Japanese legislation was designed to provide the same *sui generis* protection to IC layouts as the U.S. law. It specified, however, that an independent, nonprofit organization handle registration. Moreover, the Japanese measure made protection available on an entirely nondiscriminatory basis to chip designers of any nation.

International Economic Policy

With Japan's burgeoning trade surplus keeping Tokyo on the defensive in its relations with the United States, Europe and Asia, policymakers were constantly searching for initiatives to defuse the storm of foreign criticism before it produced new protectionist measures. Their options were limited, however. The obvious response — a complete overhaul of the economy to make it less dependent on exports for growth — could not provide the short-run changes that the international political environment required. Moreover, what other governments considered to be the second-best solution — stimulative economic policies — was not even on Tokyo's list. Reducing the budget deficit

took priority over all other considerations. A more accommodative monetary policy was also ruled out since it would backfire by widening the interest-rate differential between Japan and the United States that had already weakened the yen's value. Exports controls were out of the question as well, although this alternative was briefly explored in 1985. Aside from reminding foreign critics that Japan's bulging trade surpluses were being recycled internationally in the form of greater portfolio and equity investments, the only option left was an old standby: unilateral concessions by Japan to make its markets more accessible to imports.

Market Access Packages

Although market access packages remained Tokyo's primary response to the growing protectionist sentiment in the capitals of key trading partners, this strategy had several drawbacks. The almost annual announcements in the 1980s of new market opening measures reinforced the perception that closed Japanese markets were the major cause of the country's ballooning trade surplus, when in fact the overvalued dollar and the strong U.S. economic recovery were the keys to the problem. At the same time, because past packages had not produced the quick turnaround in Japan's trade account that many foreign critics erroneously viewed as the true test of Tokyo's commitment to an open market for imports, the 1984 and 1985 versions were often dismissed as just another public relations effort. Finally, with the dismantling of formal barriers to trade during the 1970s and early 1980s, private-sector institutional or structural factors like the distribution system and the corporate buy-national psychology assumed greater importance, and there was virtually nothing the government could do to change this situation.

1984 Package Criticism of Japan's trade policies and practices mounted in the opening months of 1984 in step with its expanding surplus. With Prime Minister Nakasone anxious to avoid a confrontation at the annual summit meeting of the major industrial democracies scheduled for early June, the government put together another series of market access initiatives. The April 27 package proposed changes in six areas:

- Market opening and import promotion - Elimination of tariffs on seven products and reduced duties on 60 others; one-year advanced implementation of tariff reductions on 1,200 items agreed to during the Tokyo Round of multilateral trade negotiations contingent on the same action by other countries; bigger import quotas for beef, oranges and citrus juices as well as nine other processed agricultural products and the removal of the quantitative limits on six additional products; deregulation of the import and wholesale tobacco products business; improved certification procedures; and implementation of programs to promote imports of specific manufactured goods.

- High technology trade - Tokyo said it would allow purchases of foreign communications satellites by the private sector, including the soon-to-be-privatized NTT, and that it would deregulate the domestic telecommunications equipment and services market on the basis of equal treatment for foreign firms. The government promised as well further "coordination of views on the protection of software rights."

- Investment promotion - Establish a new office to provide information on investment opportunities and services in Japan; expand the authority of the Office of Trade Ombudsman to handle foreign complaints about investment as well as trade; and send additional investment missions overseas.

- Financial liberalization - The government said it would continue to pursue liberalization of financial markets "independently, actively and steadily in concrete terms, taking into account economic, financial and other circumstances at home and abroad."

- Energy - A follow-up to the Japan-U.S. Joint Policy Statement on Energy Cooperation of November 1983 was pledged, including sending coal and other natural resource exploration missions to the United States.

- Foreign lawyers - The government promised to follow the advice of the Japan Federation of Bar Associations on the issue of allowing foreign lawyers to practice in Japan.

The reaction to the package in Washington and European capitals was surprisingly positive under the circumstances. Few new initiatives were outlined. Moreover, Tokyo was vague on how it planned to implement key sections of the package, including the previously announced measures to deregulate the domestic telecommunications market and open cigarette importing and wholesaling to competition, and its new pledge to allow the private sector to buy foreign communications satellites. The lack of specifics on the direction of financial liberalization also troubled American and European policymakers but did not produce overt criticism. In fact, the only part of the package that generated a critical response was the section on tariff changes. Yet as European Community officials concluded, "it is not evident [that the measures] will lead to the kind of dramatic results which would be necessary to achieve a better balance in the trade relationship" between Japan and its major partners.

1985 Package The April 1984 package bought Japan some time in American and European policymaking circles,

but its favorable impact was fleeting. As the protectionist movement continued to gain momentum in the United States and Europe, Prime Minister Nakasone and his cabinet came to the conclusion that they had to find a new way to demonstrate the government's commitment to a more open market for foreign suppliers of goods and services. The result of this search was the series of market access initiatives unveiled April 9, 1985.

At first glance, this package was no different than its six predecessors since December 1981: it, too, was long on generalities and short on specifics. The Nakasone administration announced another round of tariff cuts, saying that the list would be worked out by the end of June. It also outlined action on nine specific problems related to standards, testing or the approval process and promised to continue to monitor implementation of the measures adopted in March 1983 to improve Japan's standards, testing and certification procedures. Included in the package as well were pledges by the government to maintain the pace of financial liberalization and expand its foreign aid program. Tokyo also offered to do what it could to enable foreign lawyers to practice in Japan.

What set this package apart from earlier ones was the government's acceptance of the basic principle that access to the Japanese market for goods and services should be free, with restrictions limited to matters of national security and other exceptional situations. This approach, advocated by the Advisory Committee for External Economic Issues — a private-sector group headed by former Foreign Minister Saburo Okita, would guide the preparation and implementation of a three-year "action program" designed to provide additional market opportunities in Japan for foreign suppliers, the Nakasone cabinet promised.

In another break with the past, the prime minister announced Japan's new market access package in a nationwide television address, in part to show policymakers in the United States and Europe that he meant business. More significantly, it allowed him to take his case for a new Japanese attitude toward imports directly to businessmen and consumers.

The "action program" released with much fanfare on July 30 lived up to its name. In most areas the new list of market opening measures went beyond the statements of principle that had made up previous packages. The plan contained a timetable for change spanning the coming three years — another first. Perhaps most importantly, Prime Minister Nakasone pledged that implementation of the program would be overseen at the highest political levels to prevent the bureaucratic footdragging that had doomed many elements of earlier market access packages.

Nowhere were these differences more evident than in the section on standards and approval procedures, which was billed as the centerpiece of the six-part program. In the certification area Tokyo said it would give exporters of 13 products or product groups (electrical equipment, high-pressure gas equipment, medical devices, antiseptics and carbonated beverages, for example) increasing leeway over the next three years to self-certify that their products conformed with relevant Japanese standards. The government also planned to improve the approval process for a number of products, including such important imports as pharmaceuticals, medical equipment and cosmetics. By November 1, 1985, moreover, all ministries and agencies had to set time limits for processing applications for certification filed by foreign manufacturers.

Important changes were outlined in the testing area as well. Effective immediately, the government announced, it would accept foreign clinical test results as the basis for registering new pharmaceuticals; the only exceptions were three types of test data that might be affected by racial differences (see Part V). For products such as electric appliances, measuring instruments, motor vehicles and gas equipment and apparatus, foreign producers could submit data generated by an expanded list of testing organizations in their home countries. In addition, companies interested in obtaining Japanese Industrial Standards marks were to be allowed to use information collected by foreign testing laboratories starting in FY 1986 to prove that their products and production processes complied with this system.

To ensure the transparency of new or revised standards, Tokyo promised that representatives of foreign companies would have complete access to the formal standards-drafting process. In a related move, government officials working in the standards field agreed to continue discussions with their foreign counterparts to make sure certain Japanese standards conformed with those of other countries or international organizations. These talks covered food products, food processing and packaging equipment, fertilizers and fire equipment, as well as the use of food additives, electric appliance safety standards, vehicle safety and pollution standards, and heavy machinery health and safety standards. At the same time, the government, which had already reduced the number of technical standards for telecommunications terminal equipment (see Part V), said it planned to relax the technical standards for mobile telephones, pagers and cordless phones within the next 12 months and to take similar steps for motor vehicles, fertilizers, veterinary medicines and the transport of high-pressure gas.

The tariff changes, which had actually been previewed on June 25, were equally far-reaching, with roughly 1,850 of 2,400-plus agricultural and industrial items slated for cuts of at least 20 percent or duty-free treatment. While this coverage made the pending round of unilateral tariff changes the most sweeping in 14 years, the Ministry of Foreign Affairs had pushed for a 25 percent across-the-board cut.

This proposal ran into a wall of resistance from special interests, forcing the Nakasone administration to scale back both the scope of the tariff reductions and their depth. Moreover, to placate angry bureaucrats and politicians, the government agreed to reserve the right to rescind the tariff changes on all but 74 items if import "surges" caused "considerable" injury to domestic industries. At the same time, though, it did resist pressures to make the cuts temporary.

Highlights of the tariff changes included: 20 percent cuts on some 1,600 industrial products by April 1, 1986, including paper products, wrought aluminum, electronics equipment, film and other products of high priority to the United States; the elimination of tariffs on 32 industrial products such as telephone switching equipment, aluminum aircraft skins, lead-acid batteries and safety glass by the same date; duty reductions of 20 percent on approximately 160 agricultural products, with deeper cuts on another 42 farm commodities like boneless chicken, bananas, palm oil, wine, walnuts and pistachios; and duty-free treatment effective April 1, 1987 for 32 items previously dutiable at a rate of 2 percent or less.

The Nakasone cabinet proposed as well that both Tokyo and Washington eliminate their tariffs on data processing equipment, sophisticated medical and measuring devices, engineering plastics, nuclear reactors, radar apparatus, satellites and a long list of other high technology products. In a parallel bow to developing countries, the Japanese government promised to improve its Generalized System of Preferences, including higher ceilings starting in FY 1987 for imports eligible for duty-free treatment or preferential duties under this program. In addition, it pledged to work toward a freeze on the number of products excluded from GSP treatment and zero tariffs on eligible imports.

The section of the action program dealing with deregulation of financial and capital markets broke new ground by setting specific dates to effect the decontrol of interest rates on large time deposits; to change the regulations governing certificates of deposit and money market certificates, as well as the domestic bond market; to expand short-term money markets; and to liberalize the rules for Euroyen issues. In addition, the government reiterated its commitment to approve the applications of all nine foreign banks to engage in trust operations in Japan and to push for an increase in the number of seats on the Tokyo Stock Exchange to let foreign securities houses participate in Japan's booming market. (For additional information on the financial liberalization measures contained in the action program, see above and Part V.)

The action program also addressed the issue of government procurement, stating that more contracts would be awarded on the basis of competitive bidding and that the criteria used to screen companies interested in bidding on government contracts was to be revised. Tokyo furthermore said it would add 16 semi-public organizations to the list of 30 government ministries and agencies and 15 government-related bodies already covered by the General Agreement on Tariffs and Trade government procurement code.

If there were legitimate grounds for foreign complaints about the contents of the July 30 package, they were the sections on import quotas and services. Despite speculation that Tokyo might free imports of some agricultural commodities or food products subject to quotas, no specific actions were outlined in this area. On the issue of improved foreign access to the Japanese services sector, the action program was either noticeably silent or vague.

Exchange Rates

While the link between import barriers and Japan's soaring trade surplus was debatable, the same assessment did not apply to the misaligned yen-dollar exchange rate. Even hard-line Reagan administration trade policymakers conceded that the overvalued dollar was the primary cause of the ballooning bilateral imbalance in trade. But acknowledging this relationship and doing something about it were two different matters. The dollar's strength against the yen was the result of the big differential between interest rates in the United States and Japan and the huge outflow of capital from Japan that high U.S. returns attracted. Narrowing that gap, which amounted to roughly 4 percentage points for most of the 1984-85 period, was beyond the control of either Washington or Tokyo since adjusting monetary policies to achieve a more realistic yen-dollar exchange rate would have undermined the attainment of domestic policy objectives in both countries.

Weakening Yen The first half of 1984 was characterized by the yen's advance and subsequent retreat against the dollar. The yen had gained 4.3 percent over its initial 1984 rate by the end of March, reaching ¥224.7=$1.00. By the end of June, however, it had surrendered its gains and then some. The causes of the first quarter surge were not wholly economic: the resurgent U.S. economy combined with sluggish Japanese growth should have driven the yen down. Speculators apparently bet that the dollar was at unsustainably high levels in early 1984 and moved into yen, pushing it up. As the U.S. economy continued to barrel along, it became increasingly clear that the speculators had guessed incorrectly, and the weight of economic forces drove the yen down to ¥237.5 at mid-year.

The Bank of Japan intervened at least half a dozen times during July in an attempt to halt the yen's decline. The strength of the dollar was so pervasive, however, that the Japanese currency fell to ¥246.5 at one point. By the end of the month BOJ and Finance Ministry officials were saying

that no amount of intervention could prop up the yen, although they denied predictions that the yen would fall below ¥250 any time soon. Interestingly, exchange market experts were insisting as late as July 3 that the yen would not break the ¥240 barrier.

Toyoo Gyohten, chief of MOF's international finance bureau, briefed Prime Minister Nakasone on July 12 about the yen's drop to prepare him for the possible international political fallout. While stressing that the government would continue to intervene in the market as needed, he espoused a policy of careful observation. Mr. Gyohten also noted that concerted intervention by Japan, West Germany and the United States was not warranted under the circumstances.

The bureau chief's remarks were borne out by exchange-rate developments in the first week of August: the yen gained back most of what it had lost and stood at ¥241.40 on August 6. The yen's decline was not as steep as that of European currencies because of the strength of the Japanese economic expansion and the prospects for continued strong growth, yet many expected it to remain in the ¥240 to ¥250 range for some time. As Mr. Gyohten had pointed out to the prime minister, the yen-dollar exchange rate would not change course overnight.

In fact, the yen gave up ground to the dollar for the rest of 1984. On September 18 it dropped to a 22-month low of ¥248.3 before rallying to close the month at ¥245.5. This rally was short-lived, however, as the dollar rebounded strongly in the middle of October and pushed the yen through the ¥250 barrier on October 17. The Japanese currency recovered to ¥245.25 at the end of the month, but its erratic behavior persisted through November and December. Day-to-day changes of a full yen or more became almost commonplace in 1984's last two months. Unlike earlier periods these swings were not caused by heavy speculation, but were driven by uncertainties about the U.S. economy and interest rates. Bank of Japan officials constantly stated their willingness to intervene in the market when matters threatened to get out of hand and consistently backed their warnings with action. Intervention, though, did not prevent the yen from ending 1984 at ¥251.1, 7.5 percent less than on the year's first trading day.

The yen's volatile behavior in late 1984, it turned out, was just a preview of worse to come. After a fairly quiet January, the Tokyo exchange market was hit by buying and selling sprees that sent the Japanese currency up and down over an eight-yen band. The roller-coaster ride would have been even bumpier had not the central bank intervened frequently and heavily. As it was, the yen, which had dropped to ¥254.65 by the end of January, went into a free fall, breaking the ¥260 barrier on February 5 for the first time in more than two years and then tumbling to ¥263.4 on February 13 — its lowest level since November 1982.

Yen-Dollar Exchange Rate

Tokyo market, monthly average

Source: International Monetary Fund

Although it was not immediately obvious, the dollar reached its high-water mark in mid-February, not only against the yen but European currencies as well. By the end of the month the yen had zigzagged back up to ¥259.5. As market watchers anticipated, regaining the ground the yen had lost against the dollar was a slow process accompanied by periodic backsliding and plateaus. For example, after closing out 1985's first quarter at ¥252.5 — the exact same rate at which it had opened the year, the Japanese currency traded within plus or minus two yen of the ¥250 rate throughout the April-June period, ending the quarter at ¥248.95.

As the weather heated up in July, so did activity in the yen-dollar market. By mid-July the dollar had weakened by 10 full yen, capped by a drop from ¥242.9 on July 14 to ¥238.4 the next day. This drop prompted many market analysts to dust off their dollar-crash scenarios, but this action was premature: the American currency continued to decline in an orderly fashion, falling to ¥236.65 at the end of July and then staying very close to that level for the next month. Forecasters and policymakers on both sides of the Pacific, however, had cause for concern in September when market sentiment all of a sudden swung behind the dollar and erased all of the gains the yen had made since mid-July.

This tumble set off alarms in Tokyo. Prime Minister Nakasone was reported to have asked Finance Minister Takeshita on September 6 for a list of options that would prop up the yen by slowing the swelling volume of money flowing out of Japan. MOF's search revolved around voluntary self-restraint by both sellers and buyers of dollar instruments. Although the Foreign Exchange Control Law had been thoroughly revised in 1980 to establish open

financial markets, MOF retained many emergency controls and most of its persuasive power. Mr. Takeshita was in a quandary, however, because Tokyo's financial reform program emphasized liberalized access to foreign money markets. To suddenly put limits on dollar buying would therefore represent a complete about-face.

Mr. Takeshita reported to the prime minister on September 9 that it would be counterproductive to impose foreign exchange controls, but MOF did communicate the government's concern over the weakening yen September 12 by urging Japanese securities firms to warn customers of "possible currency exchange risks" when buying foreign, particularly dollar-denominated, bonds. This weak gesture had little impact on the market, although there was some initial nervousness over reinstatement of exchange controls. While the Finance Ministry knew that the advice would be brushed off, the fact that it was concerned enough to go ahead anyway sobered market speculators.

G-5 Agreement The dollar's renewed signs of strength also forced Washington to take a hard look at its hands-off exchange market policies. This reassessment, orchestrated by Treasury Secretary James Baker, had an unexpected outcome. After a hastily called meeting in New York City September 22, finance ministers and central bankers of the United States, Japan, France, West Germany and Great Britain announced that they would coordinate efforts to reduce the value of the dollar. Representatives of the Group of Five industrial nations agreed that distortions in world currency values contributed to large and potentially destabilizing trade and international payments imbalances, and they made it clear that they were prepared to intervene more aggressively in exchange markets. Although the five governments acknowledged that intervention could not alter the fundamental economic conditions that determine exchange rates, the communique issued by the group suggested that exchange rates at the time did not fully reflect changes in the fundamentals.

With the G-5 announcement, the yen took off, jumping from ¥241.7 on September 20, the last trading day before the meeting, to ¥217 at the end of the month — an 11.4 percent gain. During this period the Bank of Japan purchased an estimated $3 billion worth of yen to support the currency's rise. On September 30 BOJ governor Satoshi Sumita indicated that the central bank would continue to intervene actively in the exchange market. Mr. Sumita said that he would like the yen to stabilize at still higher levels, reportedly in the ¥200 to ¥210 range.

Treasury Secretary Baker and Finance Minister Takeshita met in Seoul, South Korea, October 7 and reaffirmed their commitment to lower the dollar's value in relation to the yen. Mr. Takeshita reportedly pledged that the Bank of Japan would strengthen its coordination and cooperation efforts with the Federal Reserve Board.

Despite the intention of Washington and Tokyo to further raise the value of the yen, many market participants came to the conclusion that the yen had reached its peak when it hit ¥211.9 on October 4, its highest level since April 1981. Three consecutive days of intervention by the Bank of Japan, which reportedly sold $1.5 billion to $2 billion, failed to prevent the yen from falling to ¥217 on October 9. The Federal Reserve was also thought to have intervened in the Tokyo market by purchasing $50 million worth of West German marks in an unusual move designed to demonstrate its resolve to lower the value of the dollar.

While the Bank of Japan had been relying solely on intervention to support the rise in the yen's value, it added a second policy tool in mid-October: higher short-term interest rates. By reducing the interest rate differential between the United States and Japan, the hike had an immediate impact on the yen, reinforcing its rise from ¥216.3 on October 24 to ¥202.5 on November 7. The Japanese currency then entered a period of stability, trading between ¥200 and ¥205 for the rest of 1985 with negligible intervention by the Bank of Japan, according to traders. Its year-end closing rate of ¥200.5 was the highest value since January 22, 1981 and 31.4 percent above the yen's mid-February 1985 low. Nearly two-thirds of this appreciation occurred after September 22.

Foreign Direct Investment

Outward Investment While U.S. direct investment abroad was stuck in a slow-growth pattern during the first half of the 1980s, Japanese foreign direct investment took off, jumping from a rather modest $31.8 billion in March 1980 to $83.7 billion six years later. In FY 1985 alone, Japanese corporations added a record-shattering $12.2 billion to their overseas equity holdings after investing $10.2 billion in the April 1984-March 1985 period. Virtually all the factors executives weigh in considering foreign investment continued to signal go. The ongoing U.S. economic expansion and generally favorable market conditions in other areas of the world exerted an enormous pull on Japanese businesses, regardless of their field. Higher corporate earnings and narrowing investment opportunities at home provided an equally big push. In addition, the spreading threat of protectionism in the United States and Europe gave Japanese manufacturers an extra incentive to invest in offshore production facilities. In this environment the weakness of the yen through September 1985, which raised the costs of putting money into foreign business activities, was not the deterrent that it might have been under other circumstances.

The United States remained the prime location for Japanese foreign direct investment in FY 1985, attracting an all-time-high $5.4 billion. In a repeat of the April 1984-March 1985 period, Japanese companies earmarked roughly $1.1 billion for the construction or acquisition of U.S.

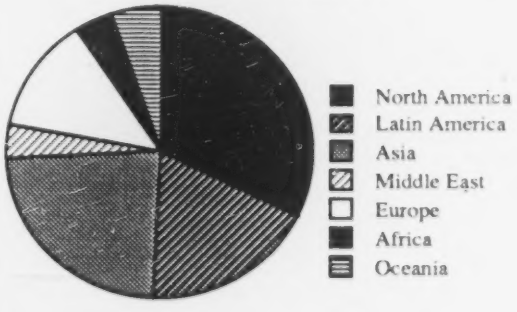
production and assembly facilities. Most of this money again went into factories to manufacture industrial and consumer electronics products, automotive equipment and metals. Japanese corporations also continued to expand their foothold in the American banking, finance and insurance sector, investing an estimated $1.5 billion. Another $0.8 billion or so was channeled into the U.S. sales organizations of Japanese companies. What set FY 1985 apart from earlier years, though, was the amount of money going into American real estate — some $1.1 billion.

For the second year in a row, Japanese businesses added $1.9 billion to their European holdings during the 12 months through March 1986. Financial institutions were again the major investors, putting another $1 billion into banking, finance and insurance subsidiaries and affiliates. More money was invested in production facilities, but the $0.3 billion addition paled in comparison with the amount going into the U.S. manufacturing sector. Europe and the United States were on a more equal footing when it came to the expansion of commercial enterprises since Japanese distributors invested $0.4 billion in European sales organizations.

While stepped-up activity in the United States and Europe was the main impetus behind the big jump in Japanese foreign direct investment in FY 1985, a large volume of capital continued to flow into the economies of Latin America and Asia. Japanese investment in Latin America, in fact, set a new record of $2.6 billion. The transportation industry remained the region's major magnet, attracting $1 billion in funds, but this time around it had a rival — the banking, finance and insurance sector, which also pulled in $1 billion. Japanese corporations continued to pursue a more diversified investment strategy in Asia. One-third of the $1.4 billion invested in this area during the April 1985-March 1986 period went into production facilities, with most of the rest divided among the services, financial and mining industries.

Japan's Foreign Direct Investment by Area

cumulative total as of March 31, 1986
in millions of dollars



Source: Ministry of Finance

The huge flow of funds going into the United States during FY 1985 reinforced North America's position as the top location for Japanese foreign direct investment. As of March 1986 corporate investors had a $27 billion stake in the United States and Canada. Masked by this number was a watershed development: for the first time, Japanese businesses had a bigger block of money in the manufacturing sector — $7.7 billion — than in the commercial sector ($7.4 billion). This new ranking, though, was just one of several signs of an evolving investment strategy. Another was the $4.2 billion that had gone into the banking, finance and insurance sector. So was the $2.1 billion invested in real estate.

Asia, the leading overseas investment site for Japanese corporations through March 1983, held onto the number-two spot in FY 1985 despite the upsurge in activity in Latin America and Europe. Out of the $19.5 billion that had been invested in this region, $7.5 billion was in metals, chemicals, textiles and other manufacturing operations and $6.2 billion in mining. Trailing Asia was Latin America, where Japanese firms had equity holdings of $15.6 billion, concentrated in production facilities ($4.6 billion), especially steel and nonferrous metals, and in transportation services ($4.5 billion).

With nearly $2.4 billion going into offshore factories during the April 1985-March 1986 period, the manufacturing sector continued to represent the leading edge of Japanese direct investment activity. By the end of the fiscal year, Japanese corporations had funneled $24.4 billion into manufacturing plants abroad, including $7.7 billion in North America, $7.5 billion in Asia and $4.6 billion in Latin America. Sales operations and mining projects remained a distant second to manufacturing facilities as the destination for Japanese foreign investment funds. A total of $12.7 billion had gone into the commercial sector, with just under three-fifths in American and Canadian sales subsidiaries and affiliates, while $11.8 billion had been invested in mining, divided almost evenly between Asian countries, mainly Indonesia, and the rest of the world. The fourth-largest concentration of money — $10.9 billion — was in overseas banking, finance and insurance organizations, anchored by investments of $4.2 billion in North America and $3.7 billion in Europe.

Inward Investment At first glance, a steady upturn in foreign direct investment in Japan should have been the counterpart to the accelerating growth of Japanese direct investment overseas. After all, the Japanese economy picked up momentum in the mid-1980s after muddling

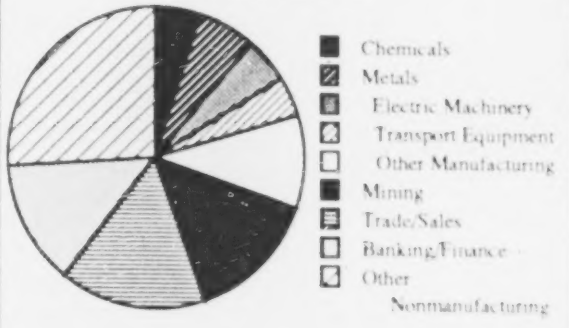
along in the earlier part of the decade, while the strength of the dollar over most of this period lowered the cost of setting up new operations in Japan or expanding existing ones. Moreover, there was a spreading awareness among corporate executives of all nationalities that one key to long-term success in the Japanese market was a local presence. Matching this recognition was a new receptivity to foreign investment at both the national and local government levels.

Despite all the signs suggesting an upswing in foreign direct investment in Japan, the results were otherwise: equity investment from abroad dropped from FY 1983's $819 million total to $493 million in the April 1984-March 1985 period and then rebounded to $780 million in FY 1985. Equally puzzling was the changing mix of new investments, acquisitions and additions to existing holdings. In FY 1984 nearly three-fifths of the investment funds moving into Japan from overseas was earmarked for the establishment of new firms, with one-fourth plowed into ongoing operations and the remainder used for acquisitions. During the April 1985-March 1986 period, however, foreign investors put 60 percent-plus of their money into existing companies; the rest was split almost evenly between new businesses and takeovers.

Behind the ups and downs of foreign direct investment in Japan in the mid-1980s and the shifting investment mix was one constant. The United States remained the main source of funds, accounting for over 50 percent of all investment in both FY 1984 and FY 1985. Trailing far behind were Hong Kong and the United Kingdom, although European investors as a group channeled about half as much money into Japan as their American counterparts in the two years.

Japan's Foreign Direct Investment by Industry

cumulative total as of March 31, 1986
in millions of dollars



Source: Ministry of Finance

Part IV

Political and Security Developments

The questioning of longstanding policies in the economic field spilled over into the political and security areas in the mid-1980s. Prime Minister Yasuhiro Nakasone's preliminary efforts to secure an unprecedented third term in 1986 as both Liberal Democratic Party president and head of government precipitated a debate over the need for continuity in leadership at a time when many government policies were in the process of change. The government's 10-year-old policy of limiting defense expenditures was also the object of considerable reexamination, in large part because of continual pressure from Washington for increased Japanese spending. The questioning even extended to Tokyo's foreign aid program as it became clear that the government would fall short of its goal of doubling assistance over the 1981-85 period.

Political Developments

The dominant political story in both 1984 and 1985 was the tenacious campaign of Prime Minister Nakasone to retain power within the Liberal Democratic Party and restore it to the commanding political position it occupied when he took office in late November 1982. Political fortunes for both the party and Mr. Nakasone had taken a turn for the worse at the end of 1983. The prime minister's essential political problem was his shallow power base (he headed one of the smallest factions in the LDP) and his continued dependence on the faction of former Prime Minister Kakuei Tanaka for support. The LDP lost more than 30 seats in the mid-December 1983 lower house elections, which led to predictions that Mr. Nakasone would be out of power no later than the end of 1984. The events of the 1984-85 period instead proved his political resilience, presenting the strong possibility that he could succeed himself as party president and premier in 1986.

Coalition Politics

"Coalition politics" was the buzzword for much of the 1984-85 period. With the LDP seriously weakened by the late 1983 elections yet able to retain power in the lower house through its coalition with the New Liberal Club, opposition party leaders felt that a potentially historic transformation in Japanese politics might be in the offing. Smaller, conservative opposition parties saw the potential for lengthy coalitions with the LDP, if not outright merger, while major opposition groups — the Japan Socialist Party in particular — felt the time was ripe to initiate a shift of power from the conservatives to the socialists. These hopes were supported by events such as the February 1984 meeting of Rokusuke Tanaka, then LDP secretary general, and officials of the Democratic Socialist Party, the number-three opposition party in Japan.

The JSP also took steps during 1984 and 1985 to increase its popularity and establish a more respectable image among Japanese voters. The party revised long-established doctrines and called for a responsible transition to a socialist government that would minimize disruptions in

the nation's economy and bureaucracy. A key element in this shift was the party's position on the country's defense policies, which was adjusted to recognize the Self-Defense Forces as "legal, but unconstitutional." Under this concept, the SDF were viewed as unconstitutional in that their existence violated the no-war clause of the constitution, but legal in the sense that they were established in accordance with proper parliamentary procedures in the Diet.

The "New Socialist Party" envisioned by JSP chairman Masashi Ishibashi thus took a more realistic approach to the Japanese political scene, although this failed to lead to measurable increases in influence over the two years. The same could be said of other opposition parties, particularly as Mr. Nakasone's personal fortunes took a turn for the better and as talk of regaining an LDP majority in the lower house increased. In fact, the only major opposition party that remained outside of the coalition talk was the Japan Communist Party, a minor factor in the overall scene with only 26 seats in the lower house following the 1983 elections.

Second Term

The coalition fever of the spring of 1984 faded, however, and attention turned to Mr. Nakasone's quest to secure a second term as LDP president and thus remain as prime minister of the government. Initially, a four- or five-man race was anticipated among Mr. Nakasone, Foreign Minister Shintaro Abe, Finance Minister Noboru Takeshita, former Foreign Minister Kiichi Miyazawa and Economic Planning Agency director general Toshio Komoto.

A flurry of meetings in March 1984 among Japan's most influential politicians marked the beginning of open maneuvering for possible successors for the premiership. Nakasone opponents spoke of forcing another lower house election, presumably with the strategy of bolstering their strength within the LDP to enable them to dump the incumbent. Failing that, they hoped to amend or suspend the party primary — a preliminary polling of the party's rank and file that selects the top three candidates for the post when contested by four or more members. The primary had been a source of strength for Mr. Nakasone, one of the most charismatic Japanese politicians in a system noted for its less-than-colorful leaders.

Eliminating the primary would have robbed Mr. Nakasone of one of his strongest claims to the presidency — his popularity among party members — and would have placed the election solely in the hands of LDP Diet members, allowing more opportunities for "back room" deals involving cabinet seats in exchange for political support. This was especially significant in light of public opinion polls that showed rising popularity for the prime minister, a distinct break from previous leaders who suffered dismal poll standings after only a short time in office.

Throughout it all, former Prime Minister Tanaka played a visible role and remained the most controversial figure in Japanese politics. Although convicted of bribery in 1983, his faction retained its power through its size and its extensive financial resources. Faction funds are crucial in local Diet elections, and Mr. Tanaka demonstrated that point in the December 1983 lower house elections when virtually all of the candidates he supported won despite the setback for the LDP as a whole. This situation would change dramatically only a few months later, but for the time being, Mr. Tanaka called the shots in the LDP — and he was still backing the incumbent.

The Cabinet

Prime Minister Yasuhiro Nakasone reshuffled his cabinet in both 1984 and 1985 despite the lack of lower house elections. In both cases the new appointments were made primarily to satisfy Liberal Democratic Party factions that sought political patronage by placing their members in important government positions.

Policy continuity was assured despite the changes by retaining key ministers, including Foreign Minister Shintaro Abe and Finance Minister Noboru Takeshita. A newcomer from the Suzuki faction, Koichi Kato, was designated the director general of the Japan Defense Agency in 1984 but was retained in the following year's shuffle. Despite having a "dove" label on taking the post, Mr. Kato became one of the strongest advocates of a moderate defense buildup within the cabinet. The decline of former Minister of International Trade and Industry Toshio Komoto was illustrated by his relative demotion to head the Okinawa Development Agency in the cabinet formed in 1984 and his subsequent disappearance from the cabinet ranks one year later. In both years members of the New Liberal Club received cabinet positions — the price the LDP had to pay after the splinter party agreed in December 1983 to form a coalition.

Key changes occurred in the party leadership positions as well, reflecting the growing importance of Shin Kanemaru, an influential politician who played a critical role in intraparty presidential negotiations in 1984. The importance of the Suzuki faction was demonstrated again in the party lineup through the designation of former Foreign Minister Kiichi Miyazawa as chairman of the LDP's executive council.

Third Nakasone Cabinet
November 1, 1984

Position	Name	Faction	Age
Prime Minister	Yasuhiro Nakasone*	Nakasone	66
Justice	Hitoshi Shimasaki	Suzuki	61
Foreign Affairs	Shintaro Abe*	Fukuda	60
Finance	Noboru Takeshita*	Tanaka	60
Education	Hikaru Matsunaga	Nakasone	55
Health and Welfare	Hiroyuki Masuoka	Suzuki	61
Agriculture, Forestry and Fisheries	Moriyoshi Sato	Tanaka	62
International Trade and Industry	Keijiro Murata	Fukuda	60
Transportation	Tokuo Yamashita	Komoto	65
Posts and Telecommunications	Megumu Sato	Tanaka	60
Labor	Toshio Yamaguchi	NLC	44
Construction	Yoshiaki Kibe	Nakasone	58
Home Affairs	Toru Furuya	Fukuda	75
Chief Cabinet Secretary	Takao Fujinami*	Nakasone	51
Administrative Management Agency	Masaharu Gotoda*	Tanaka	70
Defense Agency	Koichi Kato	Suzuki	45
Economic Planning Agency	Ippei Kaneko	Suzuki	71
Science and Technology Agency	Reiichi Takeuchi	Tanaka	58
Environmental Agency	Shigeru Ishimoto	Fukuda	71
Okinawa Development Agency	Toshio Komoto†	Komoto	73
National Land and Hokkaido Development Agencies	Kakuzo Kawamoto	Tanaka	67
Director, Cabinet Legislative Bureau	Takashi Mogushi*	—	64

Liberal Democratic Party Positions

President	Yasuhiro Nakasone*	Nakasone	66
Vice President	Susumu Nikaido	Tanaka	75
Secretary General	Shin Kanemaru†	Tanaka	70
Chairman, Executive Council	Kiichi Miyazawa	Suzuki	65
Chairman, Policy Affairs Research Council	Masayuki Fujio*	Fukuda	67
Acting Secretary General	Michio Watanabe	Nakasone	61

*Holdover
†Changed positions from previous Cabinet

As the October 1984 deadline for filing for the LDP presidency approached, potential successors to the prime minister pulled back. At one point, only Mr. Miyazawa appeared to be mounting a direct challenge, but even he realized that the Nakasone-Tanaka combination, plus the idiosyncracies of LDP presidential rules, worked against him. A last-minute attempt by Susumu Nikaido to unseat the incumbent with the backing of opposition parties failed, damaging his reputation considerably. Consequently, Mr. Nakasone filed unopposed for a second term as LDP president — a remarkable turnaround for a man whose political obituary had been written only months before.

A combination of other factors enabled Mr. Nakasone to retain power. The LDP-NLC coalition proved viable over the long Diet sessions; cabinet appointments met both policy needs and opposition requirements; and several key legislative initiatives — including the budget, medical insurance reform and reorganization of Japan Tobacco and Salt Public Corp. — were pushed through the Diet, building a respectable domestic policy record in a short period.

The unique relationship between the prime minister and President Ronald Reagan also played a limited role. As October approached, it was evident that the Republican administration would be returned to office by American voters; the only question was by what margin. Reluctant supporters of the prime minister admitted that it would be in Japan's best interests to maintain continuity in the government given the likelihood of a second Reagan term. Although it was not the major factor, the "Ron-Yasu" friendship was one element that strengthened the prime minister's bid for a second term in office.

Fourth Nakasone Cabinet
December 28, 1985

Position	Name	Faction	Age
Prime Minister	Yasuhiro Nakasone*	Nakasone	67
Justice	Seigo Suzuki	Fukuda	74
Foreign Affairs	Shintaro Abe*	Fukuda	61
Finance	Noboru Takeshita*	Tanaka	61
Education	Toshiki Kaifu	Komoto	54
Health and Welfare	Isamu Imai	Suzuki	66
Agriculture, Forestry and Fisheries	Tsutomu Hato	Tanaka	50
International Trade and Industry	Michio Watanabe	Nakasone	62
Transportation	Hiroshi Mitsuzuka	Fukuda	58
Posts and Telecommunications	Bunsei Sato	Nakasone	66
Labor	Yu Hayashi	Suzuki	61
Construction	Takami Eto	Nakasone	60
Home Affairs	Ichiro Ozawa	Tanaka	43
Chief Cabinet Secretary	Masaharu Gotoda†	Tanaka	71
Management and Coordination Agency	Masumi Esaki	Tanaka	70
Defense Agency	Koichi Kato*	Suzuki	46
Economic Planning Agency	Wataru Haraizumi	Suzuki	56
Science and Technology Agency	Yohei Kono	NLC	48
Environmental Agency	Yoshihide Mori	Komoto	66
Hokkaido and Okinawa Development Agencies	Raishiro Koga	Tanaka	70
National Land Agency	Heihachiro Yamazaki	Fukuda	74
Director, Cabinet Legislative Bureau	Takashi Mogushi*	--	65
Liberal Democratic Party Positions			
President	Yasuhiro Nakasone*	Nakasone	67
Vice President	Susumu Nikaido*	Tanaka	76
Secretary General	Shin Kanemaru*	Tanaka	71
Chairman, Executive Council	Kiichi Miyazawa*	Suzuki	66
Chairman, Policy Affairs Research Council	Masayuki Fujio*	Fukuda	68

*Holdover
†Changed positions from previous Cabinet

Third-Term Maneuvering

Following a cabinet reorganization on October 31 that left factional balances and key posts unchanged, Mr. Nakasone turned his attention to building a political base that would enable him to amend LDP rules and secure an unprecedented third term in 1986 as party president. Mr. Tanaka quickly proposed such a change which, as self-serving as it may have appeared, could be justified on the basis of maintaining continuity in government policy.

Before changes in LDP rules got off the ground, however, two developments completely changed the political scene. In early March 1985 Mr. Takeshita stunned many observers by establishing an independent "study group" in a move that was interpreted as the first step toward a separation from the Tanaka faction. The group attracted about 40 of the 120 members of the faction, with another 40 indicating interest in siding with the finance minister should he prove a viable force against the LDP's kingmaker.

Even though the Takeshita group received Mr. Tanaka's ostensible blessings, he was said to be furious with this affront to his position. Indeed, several potential members apparently thought twice about joining once Mr. Tanaka's wrath was evident. The fact that so many reconsidered indicated the influence the former prime minister retained among his followers, however disenchanted they might have been with his leadership or personal reputation.

The Takeshita move, however, proved almost prescient when Mr. Tanaka suffered a massive stroke in late February 1985 that left him hospitalized for months and unable to return to the role he once enjoyed in Japanese politics. Party

intrigue was placed on hold, both in deference to Mr. Tanaka's health and to allow party members to determine the implications for their individual and collective futures. The sign LDP members were looking for came in June 1985 when associates of the former prime minister closed his Tokyo office, a move tantamount to withdrawal from the political arena.

This left Mr. Nakasone in an ambiguous position within the party. Mr. Tanaka's health problems denied him the opportunity to shift factional support gradually. Yet he faced the need to translate his broad popular support into political power within the LDP. Public opinion polls favored such a strategy; despite occasional policy disputes, surveys showed continually rising support for the charismatic leader.

In any event, these two developments cleared the air over possible succession battles. Potential rivals narrowed to three (Messrs. Abe, Takeshita and Miyazawa) with the August 1985 bankruptcy of Sanko Steamship Co., Ltd., previously headed by cabinet member Komoto. Although Mr. Komoto was viewed at best as a distant dark horse for the post, his role in the default killed any chances of his assuming the premiership. Meanwhile, LDP elder Nikaido, who had been designated party vice president earlier in the year to boost his status and solidify the Tanaka faction's influence, made repeated statements to the effect that he would be honored to take the job if the party was unable to agree on a successor to Mr. Nakasone. Japanese observers, however, discounted the possibility of his becoming prime minister.

As the political season entered a temporary lull in the summer of 1985, Mr. Nakasone and his supporters laid out a plan of action to not only maintain but expand his political power. It became evident that the prime minister hoped to amend LDP rules to allow him to succeed himself for another term. To do so, however, he would need to build on his popularity among voters and the party rank and file to develop a mandate for a third term. The plan depended on several events, including a special session of the Diet in the early fall, centering on electoral reform; a regular Diet session at the end of 1985 with reorganization of the Japanese National Railways a major issue; a smashing diplomatic success at the annual economic summit meeting of the leaders of the free world's seven major industrial powers, which was scheduled to be held in Tokyo in May 1986; and a victory at the polls in upper and lower house elections in June 1986.

An appearance before the United Nations General Assembly on October 23, 1985 helped boost Mr. Nakasone's political position at home. Although critics discounted his speech as still another effort by the prime minister to divert public attention from domestic shortcomings by emphasizing international affairs, it nevertheless marked the first such appearance by a Japanese prime minister in the organization's history.

Legislative Issues

Legislative actions in the 1984-85 period were highly significant for Japan's economy as well as the political scene. Although Diet business bogged down frequently during the regular and extraordinary sessions over the two years, legislators might well be remembered for tackling more thorny issues during this period than at any time in recent memory. Among these issues were administrative reform, including the reorganization of Nippon Telegraph and Telephone Public Corp. and JTS and the deregulation of the domestic markets for telecommunications equipment and services and tobacco products; legal protection for computer software and semiconductor designs; changes in the national health insurance program; and revision of lower house electoral districts.

1983-84 Diet Actions

The regular session of the Diet that convened in December 1983 was applauded for its rapid approval of the fiscal 1984 budget, but other politically sensitive issues forced a 77-day extension of the 150-day session on May 24, 1984. Opposition parties strongly objected to the extension, in part because they felt it might be a backdoor means of calling lower house elections before the LDP convention in the fall.

Rumors of a lower house election accelerated when it became clear that, despite the poor 1983 showing at the polls, Mr. Nakasone was intent on retaining his LDP presidency for another two years following the expiration of his first term in October 1984. A lower house election, some observers felt, would be one way of strengthening his hold on the party, particularly in light of Mr. Nakasone's rising popularity in public opinion polls. The extended Diet session was also an opportunity for the prime minister to counter charges that he lacked a domestic agenda.

These political factors — coupled with debates over controversial health insurance legislation — thwarted the LDP-NLC coalition's desire to complete action on outstanding business by the August conclusion of the extended session. Consequently, when the Diet convened December 1, 1984 for its next regular session, it faced the same range of tough issues as those addressed by legislators in the previous session. Priority items included the fiscal 1985 budget; reorganization of NTT and deregulation of the domestic telecommunications market; protection of

intellectual property rights; and reapportionment of election districts for the Diet's lower house.

1984-85 Diet Actions

Budget issues were cleared from the agenda in short order, as was the case in 1984. One of the remarkable aspects of the Nakasone government during the mid-1980s was its ability to expedite passage of the budget despite severe opposition from minority parties and the necessity of working through its coalition partner, the New Liberal Club. The 1985 budget debate was also significant for the relative lack of controversy over defense spending, even though expenditures were moving ever closer to the ceiling of one percent of gross national product.

Most of the government's bills were approved by the Diet during the regular session, including the privatization of NTT and legal protection for software and semiconductor designs (see Part III). Nevertheless, several priority items — most notably, JNR reorganization and electoral reform — were left in limbo, forcing a special session that opened on October 14, 1985. Legislators once again grappled with electoral reform, but opposition to the legislation was so strong among both the LDP and opposition parties that it failed to reach the floor for a vote, seriously damaging the prime minister's chances for securing a third term as LDP president. The special session therefore ended December 21, 1985 with nothing to show for the months of study of the electoral reform issue.

No issue hovered over the Diet with as many political implications as the problem of reforming lower house election districts to eliminate disparities in relative voting strength between rural and urban constituencies. The LDP was forced to address this issue after the Supreme Court ruled on November 7, 1983 that the existing system was in conflict with the constitution. A subsequent ruling on July 17, 1985 supported previous judgments and labeled the December 1983 elections "unconstitutional." Although the court did not nullify the results of the election, it indicated that future ballots could be voided if the situation was not rectified.

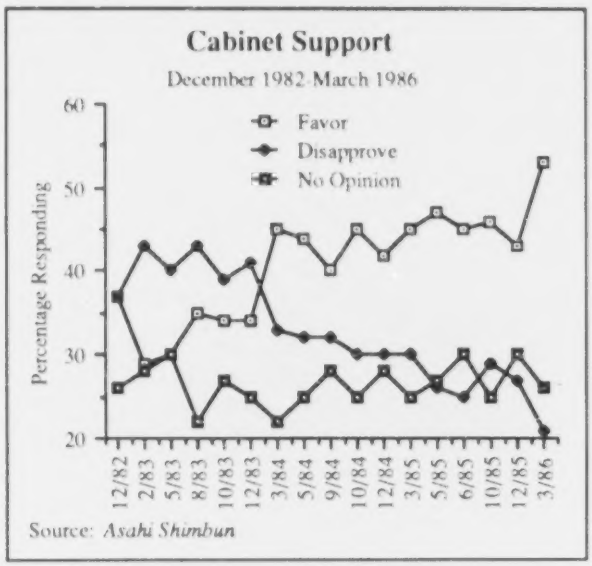
This severely restricted Mr. Nakasone's power to call elections, which figured prominently in his long-term plans. Party leaders ultimately proposed shifting six seats from the most over-represented districts to six comparably under-represented districts. This proposal came under immediate fire, both from opposition parties that feared the possible loss of representation in the lower house and from LDP factions whose members would be affected by the reallocation of seats. The controversy meant that the bill was not introduced to the Diet until May 1985, too late in the regular Diet session to enable serious consideration by the members.

Although the issue never reached the legislative stage in the 1984-85 period, the question of reforming Japan's educational system to meet present deficiencies and future needs was a top priority for Mr. Nakasone. The prime minister's ad hoc commission on educational reform presented its preliminary findings on June 26, 1985, calling for modifications of the existing system to allow greater individuality in education — a shift away from the traditional thrust toward uniformity in both approach and content.

In broadest terms, the reform drive focused on three perceived weaknesses: the lack of opportunity for students to express their individuality and pursue more customized courses of instruction; the growing pressures generated by the country's entrance examination system; and a drift from social values that threatened to create social unrest in a nation whose survival is viewed as being tied to consensus and group dependence. The group's conclusions were somewhat vague, but nevertheless underscored the broad points raised by reform proponents.

Nakasone's Popularity

Despite occasional setbacks, public opinion polls indicated surprisingly high rates of approval for both the government and Prime Minister Nakasone throughout 1984 and 1985. An *Asahi Shimbun* survey taken May 15-16, 1985, for example, showed all-time high public support for a postwar cabinet at a similar stage. Although previous governments had had higher approval ratings, these came only during the early months of tenure. The *Asahi* survey



indicated a reversal of the usual pattern: support for Mr. Nakasone generally was on the upswing, while his opposition steadily declined.

Several explanations could be offered for this state of affairs: the premier's immense personal popularity; the relatively stable performance of the Japanese economy; and the tendency to support the government simply because it had survived longer than its recent predecessors. The average political lifespan of a prime minister in the 1960s and 1970s was about two years; Mr. Nakasone had completed more than three by the end of 1985 and appeared likely to serve until the end of his term in the fall of 1986.

Security Issues

The dominant defense issue during much of 1984 and 1985 was whether to retain the longstanding limit on defense spending of one percent of GNP. Instituted in 1976 by the Miki cabinet as a means of assuring defense critics that the formal defense outline adopted at that time would not mean rampant defense spending, the ceiling came under pressure almost immediately. This situation only worsened in the mid-1980s as policies became more ambitious.

One Percent Debate

Unrelenting political pressure from the United States on Japan to increase defense spending, both for trade and security reasons, kept the one percent issue active, while weapons procurement tested the resourcefulness of Japanese defense budget planners as new commitments required larger portions of the budget. Most important, however, was Prime Minister Nakasone's desire to rid the government of what he perceived as an artificial and prohibitive spending cap and rely instead on the Japan Defense Agency's five-year plans as a means to monitor defense outlays.

Moderate to strong economic growth in 1984 and 1985 bought time for the policy and prevented the violation of the spending cap. The prime minister, however, was not satisfied and chose to force a decision on the policy as JDA completed its FY 1986-FY 1990 plan in September 1985. Critics of higher defense spending quickly banded together to oppose the move to revise or scrap the spending limit. Another factor might have played a significant although not decisive role: potential successors to Mr. Nakasone as LDP president hoped to quash speculation over another term in office by taking advantage of the defense issue to undermine support for the incumbent. Furthermore, Mr. Nakasone possibly underestimated popular support for the policy.

A consensus was reached in mid-September retaining the one percent limit — a political setback for the prime minister. At the same time, though, officials agreed to elevate JDA's five-year budget estimates to the status of an official government plan, thereby providing the agency with greater bargaining authority.

Japan's Initial Defense Budget

Fiscal Year	Budget (billion yen)	Percent Change	Budget/GNP Ratio
1955	¥134.9	3.3%	1.78
1965	301.4	9.6	1.07
1975	1,327.3	21.4	0.84
1980	2,230.2	6.5	0.90
1981	2,400.0	7.6	0.91
1982	2,586.1	7.8	0.93
1983	2,754.2	6.5	0.98
1984	2,934.7	6.6	0.99
1985	3,137.2	6.9	0.99

Source: Japan Defense Agency

Five-Year Plan

The cabinet approved the new five-year defense program covering FY 1986-FY 1990 on September 18, 1985. The plan aimed to improve air defense capabilities and secure the approaching sealanes to a distance of 1,000 nautical miles; enhance defensive capabilities against a manned invasion of Japanese territory; focus on sustainability and improved command, communications, intelligence and reconnaissance; and rationalize the Self-Defense Forces to improve their efficiency. Implicit in these objectives was JDA's conviction that the Soviet Union posed a continuing threat to Japan, despite renewed political contact between Moscow and Tokyo after years of neglect.

The specific procurement programs to achieve the plan's goals spanned acquisition of the Patriot surface-to-air missile system to replace outdated Nike missiles; continued acquisition of F-15 fighters and E-2C early warning aircraft; and strengthened antisubmarine warfare fleets, including additional P-3C patrol aircraft, which are regarded as the most capable aircraft of their kind. The SDF planned to rely on technology more than manpower to improve their invasion defenses — for example, by deploying SSM-1 surface-to-surface missiles, a domestically designed and manufactured system capable of striking a ground object at a distance of 62 miles.

Many anticipated improvements were qualitative rather than quantitative. To cite just one example, by the conclusion of the new five-year plan, the SDF would still have 10 squadrons of interceptor aircraft; however, reliance on newer F-15 interceptors would increase since older

F-4EJs were scheduled to be phased out or converted to reconnaissance aircraft. Although the total inventory of fighter aircraft would only increase from 155 to 187 by March 1991, the qualitative difference was expected by most analysts to be significant.

Long-term studies were also initiated that could influence future acquisition plans and possibly even the FY 1986-FY 1990 program. An examination of in-flight refueling and enhancement of existing F-4s was to be conducted to determine means of improving Japan's air defense capabilities, particularly as they related to the government's commitment to defend the sealanes approaching Japan to a distance of 1,000 nautical miles. Moreover, over-the-horizon radar was targeted for study to determine both the desirability and feasibility of introducing such systems to the SDF.

At the time the FY 1986-FY 1990 plan was adopted, JDA estimated that ¥18.4 trillion would be required to satisfy program goals. Of the total, 41.3 percent would be devoted to personnel and provision costs, with 25.8 percent allotted to major hardware acquisitions and the remaining 32.9 percent designated for logistical support. JDA noted that it would reevaluate its program again in 1988.

Defense Cooperation

Given Japan's relatively low overall spending levels on defense, the United States continued to seek additional, non-monetary contributions to regional and global security. Japan responded in part by increasing its official development assistance (see below), characterizing the program as a humanitarian venture that also satisfied regional security demands by eliminating many sources of unrest and instability. A contribution more highly valued and emphasized by the Department of Defense, however, was Tokyo's willingness to share technologies that have both commercial and military applications with the United States. Policy momentum in this area continued in the mid-1980s, but with few assurances that it would produce major developments in the future.

The completion of two technology transfer reports by the Defense Department contributed to the policy momentum. The first — *Industry-to-Industry International Armaments Cooperation, Phase II: Japan* — was released in August 1984. The study outlined a broad approach toward facilitating technology transfers between the two countries. Although the report contained several potentially controversial observations, it stirred little protest in either Japan or the United States. The second report reviewed Japan's opto-electronics and millimeter/microwave technologies. This report was released to the public in 1985 following a series of visits to private-sector and government laboratories in Japan. The study was the first comprehensive assessment of Japanese capabilities by DOD in a specific industrial sector and was significant in identifying American interests and potential areas of cooperation.

Additional notes completed in December 1985 outlined the roles and range of authority for JDA, the Ministry of International Trade and Industry and the Pentagon in technology transfers. They also included provisions regarding security safeguards and financial compensation. Yet there was only limited evidence of bilateral technology cooperation. One of the principal obstacles to transfers remained the private sector's reluctance to "give away the store" to a potential competitor. Japan continued to be leery of policies — even with an ally — that would compromise its strict self-defense posture in security matters and revive memories among Southeast Asian nations in particular of Japan's militaristic period.

In addition, there was growing concern in the United States about increased reliance on Japanese components in U.S. defense systems. This meant that technology transfers were being promoted at the same time attempts were being made to reduce them. DOD hoped that completion of the 1985 detailed notes would rectify this situation and facilitate technology flows. The two countries completed the first transfer agreement under the new notes in December 1985, providing for the release of Japanese technology in the area of missile guidance systems.

Several developments took place in the mid-1980s that went largely unnoticed by the popular media in Japan and the United States, indicating the degree to which defense debates had matured in both countries. These included the deployment of nuclear-capable Tomahawk cruise missiles on U.S. vessels in the Pacific, the port calls of two nuclear-powered carriers (the *Carl Vinson* and the *Enterprise*) and the completion of a bilateral sealane defense study, a critical element in joint planning.

Any of these developments would have incurred considerable public wrath in Japan in the past, particularly those involving potential violations of the nation's three nuclear principles — no manufacture, possession or deployment of nuclear weapons on Japanese territory. Protestors did demonstrate against the Tomahawk and Carl Vinson episodes, but they were minor and grew even less significant with the passage of time.

A major milestone in bilateral cooperation was the completion in 1984 of a joint sealane study. Although the details of the study remained secret, press reports suggested that the plan included contingencies for defending the three critical straits and sealanes approaching Japan against enemy intrusions, with maximum reliance on the Maritime Self-

Defense Forces. The study was concluded after two years of U.S.-Japan consultations.

Finally, Japan's participation in joint exercises with the United States and its Pacific allies — the Rimpac exercises — increased in the mid-1980s, with 1985 marking the SDF's greatest participation to date. Not only did the participation indicate a greater degree of bilateral cooperation, but it also enhanced SDF capabilities.

While these developments passed largely unnoticed in the Japanese press, the same was not true of President Reagan's Strategic Defense Initiative, popularly known as Star Wars. SDI proved to be highly controversial in Japan. Tokyo was methodical in assessing the research and development program since it was first invited in the spring of 1985 to participate. Two high-level delegations visited the United States in 1985 (a third was scheduled for January 1986) to review anticipated roles and contributions of the Japanese government and private sector.

Objections to the program centered in part on its technological merits, with both public and private-sector officials worried about potential American demands for highly advanced Japanese technologies that could have commercial spin-offs. There were also political constraints that were difficult for Mr. Nakasone — SDI's strongest supporter in Tokyo — to overcome. Foreign Minister Abe, a potential Nakasone successor, was said to be cool to SDI and might have sought a delay on the question of Japanese involvement until such a time as Mr. Nakasone stepped down from power.

Public opinion polls suggested concern and skepticism over the program. There was widespread uneasiness that participation would take Japan far beyond its present self-defense mode into the arena of collective security. Several observers also questioned Washington's priorities in deploying SDI systems. These factors helped to explain Tokyo's failure to reach a decision in 1985 on whether Japan would participate in the program.

FSX

One of the most controversial issues that faced Japanese defense policymakers in the 1984-85 period was the decision regarding a new support fighter to replace outmoded F-1s and perhaps F-4s as well. Domestic industries lobbied heavily for a Japanese-designed and manufactured aircraft, dubbed the FSX, or one that had a high proportion of domestic inputs. JDA hoped to reach a decision on the issue by mid-1986.

The FSX debate marked an increasing emphasis by MITI and Japanese defense contractors on a greater degree of self-sufficiency in defense production. This emphasis was noted for the first time in the 1984 defense white paper. Many observers felt that this threatened to precipitate problems with the United States in light of the growing trade deficit with Japan — particularly in the FSX case. Such fears were legitimate, but the trade-defense linkage remained latent.

Congressional Input

Although individual members of Congress made sporadic efforts in the mid-1980s to spur Japan to greater defense spending, Capitol Hill as a whole was ineffective in either influencing the nature of bilateral defense consultations or the pace of Japanese spending. A burden-sharing amendment offered by Sen. Carl Levin (D., Mich.) in 1984 contained strong language that called on Japan and other U.S. allies to accelerate defense spending. However, it refrained from establishing a specific target for Japanese defense budget hikes, as it did for NATO (North Atlantic Treaty Organization) allies.

When JDA director general Koichi Kato visited Washington in early June 1985, both chambers overwhelmingly approved a new resolution strongly criticizing Japanese defense policies and calling for annual assessments by DOD of Japanese progress in meeting its defense goals. The resolution caused U.S. and Japanese officials considerable embarrassment and was an unprecedented exercise in judgment about an ally's policy planning and implementation capability.

Foreign Aid

Tokyo's 1981 plan to double its official development assistance to $21.4 billion over the next five years came to an end in 1985. The results were disappointing, to put it mildly. With cumulative disbursements of just under $18.1 billion over the 1981-85 period, Japan achieved only 84.6 percent of its goal. The fact that a large part of the blame for the shortfall was attributable to the yen's weakness against the dollar did little to ease the frustration of foreign aid policymakers and other government officials anxious to demonstrate to an often doubting international community that Japan was prepared to assume more responsibility in the world economy. Still, if the yen had remained near the rate at which it was when the doubling target was set in January 1981 — ¥202=$1.00 — instead of dropping to an average ¥238.54 in 1985, Tokyo's goal would have been easily met.

The strength of the dollar on Japan's foreign aid program was particularly evident in 1985. ODA disbursements, which had expanded by 14.8 percent in 1984, dropped by 12.1 percent that year to $3.8 billion. Not surprisingly, the ratio of ODA to Japan's GNP fell as well, slipping to 0.29 percent — the first time in three years that this key

international measure of aid had gone below 0.3 percent. In the process, moreover, Japan resumed its position as the third-largest ODA donor nation behind the United States and France after moving into second place in 1984.

Japan's Official Development Assistance

(in millions of dollars)

	1981	1982	1983	1984	1985
Bilateral ODA	$2,260	$2,367	$2,425	$2,427	$2,557
Grants	810	805	993	1,064	1,185
Grant Assistance	432	412	535	543	636
Technical Assistance	378	393	458	521	549
Loans	1,450	1,562	1,432	1,363	1,372
Multilateral ODA	911	656	1,336	1,891	1,240
Total ODA	3,171	3,023	3,761	4,319	3,797
Ratio of ODA to GNP	0.28%	0.28%	0.33%	0.34%	0.29%

Source: Ministry of Foreign Affairs

In addition to exchange rate problems in 1985, delays in certain multilateral disbursements and sluggish world economic growth all contributed to the largest percentage drop in ODA in 21 years. The delays were blamed primarily on a slow-moving bureaucracy, while economic growth limited recipient nations' capacities to absorb Japanese aid. Policymakers in Japan examined means of rectifying the former situation, although the latter problem placed them in something of a Catch-22 dilemma.

Japan's ODA program also suffered a major setback both in terms of aid flows and public relations in late 1985 as a result of the change of government in the Philippines, which traditionally numbered among the top five recipients of Japanese aid. Development assistance was suspended during the course of the political upheaval there. With the end of the Marcos regime also came allegations that Japanese firms and the aid bureaucracy were involved with illegal payoffs in connection with development projects. As the year came to a close, aid officials were reviewing the program with the intention of reactivating it as soon as possible.

Part V

U.S.-Japan Economic Relations

Economic expansion in 1984 and 1985 and important elections in both Japan and the United States put pressure on policymakers to find solutions to several old and some new bilateral trade issues. Unlike previous economic rebounds, the American recovery did not ease trade frictions by providing a bigger pie for everyone. An increasing number of industries experienced strong competition from Japanese manufacturers. At the same time, the return of moderate growth in Japan provided little additional stimulus to U.S. exports, whether manufactured products or industrial and agricultural inputs. The result was familiar: the U.S. trade deficit with Japan ballooned to once-unimaginable levels, as did the overall red-ink trade entry. Japan had the opposite problem; its trade surplus began to take on proportions not seen since the Organization of Petroleum Exporting Countries raised crude oil prices drastically in the 1970s.

The November 1984 presidential elections in the United States spurred both sides to settle several problems before the campaign heated up, resulting in a minor role for bilateral trade issues after mid-year. After an often contentious first half of 1985, the truce was reinstated through the end of the year in deference to Prime Minister Yasuhiro Nakasone's campaign for a second term. Admittedly, some issues remained unresolved at the end of 1985, most notably semiconductors, but many important breakthroughs had been made. In particular, successful talks on telecommunications equipment and services, a highly technical area, and intellectual property protection, a new field, pointed to another stage in bilateral relations.

Overview

Rethinking Strategy

A New White House Approach With the soaring bilateral trade deficit of the mid-1980s constantly fanning the protectionist fires on Capitol Hill, the Reagan administration was hard-pressed to defend its approach to the management of trade issues with Japan. The strategy of trying to gain better access to Japanese markets for American exporters by targeting one specific problem area — say, Japan's import quotas on beef and oranges — and then moving on to another one problem-one issue area had netted only piecemeal results after generally protracted negotiations. This track record, economic policymakers concluded, would not stem the protectionist tide in Congress; an entirely different approach was needed.

The White House's answer was in-depth sectoral negotiations to improve Japanese market opportunities for highly competitive American exports. Previewed during the 1984 financial liberalization talks, this negotiating strategy came into its own at the start of 1985 with the launch of the awkwardly named market-oriented, sector-selective discussions. The idea behind the MOSS format was deceptively simple: select a handful of product areas where Japanese restrictions prevented U.S. manufacturers from fully exploiting their technological or pricing edge and then

tackle the whole range of barriers that could impede free access — including private-sector institutional or structural factors as well as government-created and government-sanctioned barriers to imports. Trade officials readily conceded that this approach would not produce the short-run turnaround in the huge bilateral trade imbalance that protectionist-minded legislators were demanding, but they saw no other option.

Although largely discredited, the Reagan administration did not completely abandon its old strategy for handling the market access question, periodically adding a high-visibility single-issue problem to the Japan negotiating agenda. Cigarettes were one example; foreign membership on the Tokyo Stock Exchange and the entry of foreign banks into the Japanese trust banking business were two others. By using this way of highlighting additional areas where American companies were clearly competitive yet denied equal market opportunities in Japan, Washington made it hard for Tokyo to quarrel with the logic of market liberalization.

A New Emphasis By the early 1980s two-way U.S. trade with Pacific Rim nations surpassed trade flows between the United States and Europe. In 1984 the Reagan administration finally began to devote attention to Far East matters commensurate with the economic importance of the region. This did not mean downgrading relations with European allies but rather bringing Japan into the same spotlight as Europe.

Speaking in early 1984, Under Secretary of State Lawrence S. Eagleburger said that divergent interpretations of international security problems had produced "what I would have to describe as the shift of the center of gravity of U.S. foreign policy from the trans-Atlantic relationship toward the Pacific Basin and particularly Japan." While noting that relations between the United States and Europe had not deteriorated to the point that "nothing can be done about it," he nevertheless concluded that "the Pacific and clearly Japan are consistently taking a more important role, at least in terms of the world economic situation."

At about the same time, U.S. Trade Representative William E. Brock voiced a new moderate view on the bilateral trade imbalance. Testifying before the Joint Economic Committee of Congress, Mr. Brock noted that even if all Japanese barriers to U.S. exports were removed, only half of the deficit at best could be eliminated. In the same breath the top U.S. trade official asserted that "more intractable" problems existed with European allies.

This theme was repeated in an April 2, 1984 speech by Donald P. Gregg, special assistant for national security affairs to Vice President George Bush, when he declared that minor economic disputes should not be allowed to disrupt the larger and more important political relationship between the United States and Japan. Where Europe considers Japan an economic threat, he said, the United States looks on it as a key member of the Western alliance.

And A New Style This shift in approach and emphasis inevitably led to a new style of negotiations. American business representatives immersed themselves in technical details on an unprecedented scale in an effort to win equitable access to Japanese markets. At the same time, administration officials engaged their Japanese counterparts in discussions about the ideal shape of the Japanese economy and regulatory structure, trying to create a vision of a new Japan that would guide bilateral relations over the coming years. All the while White House spokesmen tried to play up any negotiating progress in an effort to restrain "Japan bashers" in Congress, whose widely reported comments only served to sour the atmosphere. Of course, the administration was not above using the threat of congressional action as a stick to encourage Tokyo to move on some issues. On the other hand, it actively upheld its free-trade philosophy by lobbying against several anti-Japan congressional initiatives.

Personnel Changes In early January 1985 Donald Regan and James Baker decided to swap jobs, with Mr. Regan becoming White House chief of staff and Mr. Baker taking up the reins at the Treasury Department. Although at first it appeared that a "hard-liner" on Japan had moved into the White House inner circle, Mr. Regan's input on Japan-related issues was limited. The new Treasury Secretary continued to articulate the administration's free-trade policies after taking over the department while adding the principle of fairness to free trade. This addition may have had political appeal, but it proved difficult to translate into effective policies and negotiating positions.

Six months later there was another major shake-up. USTR Brock became the Labor Secretary, and the Under Secretary of Commerce for International Trade, Lionel Olmer, entered the private sector. The disarray was compounded when Deputy USTR Robert Lighthizer submitted his resignation a short time later. Morale at the trade representative's office was low at an important juncture in relations with Japan. Although replacements were quickly designated — Clayton Yeutter as USTR and S. Bruce Smart for the Commerce job — the scheduling of confirmation hearings was delayed, prompting some observers to suggest that the White House was not paying full attention to trade concerns.

Others noted that while the installation of new officials in the administration might mean delays in formulating positions toward Japan, this was an auspicious time for change since the first phase of the MOSS negotiations had come to a close and the Nakasone government was preparing

its own list of additional market opening measures. The hiatus provided some respite for the newcomers to familiarize themselves with the issues. Nevertheless, the perception of a vacuum in trade policy leadership within the administration permeated Congress and encouraged the development of protectionist legislation.

Japan's Response

At first glance, the pattern of Japan's responses to U.S. pressures for better market opportunities for American suppliers of goods and services seemed unchanged from previous years: Washington would press for changes, Tokyo would resist, but at the last minute would make some concessions; or Tokyo would unveil a new package of market access measures immediately before an important meeting to reduce tensions. Prime Minister Nakasone, however, lived up to his image as an atypical Japanese politician by taking the lead on several bilateral trade issues. These initiatives were just one sign that Mr. Nakasone, more than his predecessors, understood the domestic political ramifications of the big U.S. trade deficit with Japan and the strain the expanding imbalance was placing on an otherwise strong bilateral relationship.

During a January 2, 1985 meeting in Los Angeles with President Reagan, for example, Prime Minister Nakasone took the initiative on bilateral trade problems by addressing Washington's concern that American suppliers might not have the same access to Japan's deregulated telecommunications market as their Japanese competitors. He also pledged continued efforts by his government to facilitate sales of American-made products. To this end, Mr. Nakasone proposed a new series of high-level market access talks — a suggestion that dovetailed with the Reagan administration's plans to launch intensive sectoral negotiations within the MOSS framework.

The prime minister again demonstrated his atypical leadership style in April 1985 when he asked his countrymen to open their minds as well as their pocketbooks to foreign goods and services. In an unprecedented live television broadcast following the announcement of a series of market access measures (see Part III), Mr. Nakasone argued that Japan must adopt a new attitude toward international trade if it was to continue to prosper. He highlighted his call for a more balanced approach to trade by turning the nation's postwar slogan of "export or die" on its head to become "import or die." Japan, he reminded viewers, was perceived abroad as reaping only benefits from the global free-trade system while not bearing any responsibility for its maintenance.

Mr. Nakasone's speech, which stimulated a wide-ranging debate in Japan on trade policy, marked the starting point of the lengthy process of reorienting national attitudes. One immediate outgrowth of this reexamination was a suggestion by the ruling Liberal Democratic Party in the spring of 1985 that Tokyo impose a temporary surcharge on exports to preempt restrictive actions by Japan's trading partners. The prime minister quickly rejected this approach, arguing that it would be interpreted overseas as an attempt to avoid further market opening measures and that it would precipitate the very protectionist reaction that it was designed to prevent. He also noted that it would damage smaller export-oriented businesses while having a questionable impact on Japan's growing trade surpluses.

Another hallmark of Mr. Nakasone's leadership was his administrative reform campaign, which went into high gear in the mid-1980s with the privatization of Nippon Telegraph and Telephone Public Corp. and Japan Tobacco and Salt Public Corp. and the deregulation of the domestic markets for telecommunications equipment and services and tobacco products. Deregulation, particularly of the telecommunications market, was testimony to Tokyo's commitment to improve market access and reform its economic structure. To be sure, pressure from Washington was important in guaranteeing equal treatment for foreign firms in the deregulated environment and in getting Tokyo to make its bureaucratic procedures more objective and transparent. As discussed in Part III, however, the major impetus for reform originated from domestic sources.

In the fall of 1985 Mr. Nakasone took the concept of administrative reform one step further, appointing an advisory commission to recommend ways in which Japan could improve its economic relations with other countries. While this sounded vague, the prime minister hoped that the panel of academic, business and government leaders headed by former Bank of Japan governor Haruo Maekawa would come up with nothing less than a broad overview of a completely restructured Japanese economy. At the group's first meeting in late October, Mr. Nakasone stressed the importance of domestic-demand led growth and said he was committed to an overhaul of economic policies to reduce frictions with Japan's trading partners. The commission's report, released in March 1986, would further crystallize the debate over the nation's economic future.

Access To Japan's Markets

Tokyo's unilateral market liberalization actions in 1984 and 1985 (see Part III) were not nearly enough to satisfy the Reagan administration's goal of markedly improved access to Japan's lucrative markets. In line with its new approach to the market access question, the White House carefully selected its targets, trying to emphasize new or emerging markets or ones where American companies were highly competitive. As a result high technology issues and

problems in the services sector made up most of the items on Washington's negotiating agenda, although some old standbys like beef and oranges, cigarettes and leather reappeared.

Financial Markets

The prototype for the MOSS negotiations that occupied center stage during 1985 was the series of high-level bilateral discussions held in 1984 on the twin issues of deregulation of Japanese financial and capital markets and internationalization of the yen. These talks were set in motion during President Reagan's November 1983 visit to Tokyo. During that trip American economic policymakers, worried about the undervaluation of the yen in relation to the dollar, won the backing of their Japanese counterparts for the establishment of a U.S.-Japan working group to explore measures that would internationalize the Japanese currency and presumably raise its value on exchange markets.

Washington's new emphasis on yen internationalization was rooted in its belief that if the yen were more widely used as a transaction currency in trade, an investment currency by foreigners and a reserve currency by other governments, its value would rise. The Reagan administration therefore wanted Tokyo to change regulations that made the yen less attractive to use and hold. Without adopting the position that the Japanese government deliberately maintained these regulations to depress the yen's value, American officials argued that whatever their original justification, such policies were operating against yen internationalization and a stronger Japanese currency.

At the same time that the Reagan administration was pushing Tokyo for regulatory changes to boost the yen's value, the Japanese government was under increasing pressure from American financial institutions eager to expand their presence in the domestic market. Since interest rates are lower in Japan than elsewhere, part of the financial community's interest was in tapping Japanese capital for investment abroad, a flow that would push the value of the yen down rather than up. Nevertheless, Washington adopted the position that wholesale liberalization of Japanese capital markets would bring Japanese interest rates up to world levels, at which point the incentive for capital to flow out of the country would disappear and thereby support yen appreciation.

Yen-Dollar Accord The financial liberalization talks got off to a rocky start as both Washington and Tokyo took predictable positions at the February 23-24, 1984 meeting of the yen-dollar working group — formally known as the Joint Japan-U.S. Ad Hoc Group on Yen/Dollar Exchange Rates, Financial and Capital Market Issues. U.S. negotiators went to Japan with five topics on their agenda: yen internationalization, liberalization of Japanese interest rates, a flexible expansion of financial offerings, further development of capital markets, and fewer restrictions on direct investment in Japan. The Japanese side came to the meeting hoping to seek "understanding" from the United States about why policies could be changed only slowly. Under Secretary of the Treasury for Monetary Affairs Beryl Sprinkel, who headed the American delegation, expressed dissatisfaction with the meeting and the Japanese response, adding that he wanted a plan by the next meeting outlining fundamental changes in financial and capital markets.

In an effort to show Washington the depth of Tokyo's commitment to reform, Tokyo made good on its November 1983 pledge to initiate several regulatory changes. These changes were incorporated in an omnibus Ministry of Finance bill that the cabinet approved in early March. They included allowing the government to issue public debt bonds denominated in foreign currencies; permitting foreign companies to apply for government loans; easing the deadlines for annual securities reports for foreign-owned companies; and eliminating the restrictions on foreign acquisitions of the stock of particular Japanese corporations and of real estate.

MOF and the Bank of Japan also began their promised expedited study of a yen-denominated bankers' acceptance market — a facility that could increase the demand for the yen. A second study was initiated as well on the creation of a treasury bill market similar to the one in the United States, a change that BOJ governor Maekawa termed "natural and desirable." It would add to the pressure for the decontrol of interest rates and force the central bank to replace monetary adjustment tools with open market operations. Despite his positive comments, Mr. Maekawa did not suggest a timetable for this innovation.

The second meeting of the yen-dollar working group, held in Tokyo March 23-24, was expected to build on the momentum generated by these changes. This hope was quickly dashed, however. In talks with Finance Minister Noboru Takeshita the day after the meeting, Treasury Secretary Regan blasted the lack of progress and even warned that frustration in Congress could lead to retaliatory measures that the White House would be unable to prevent. Unfortunately, these remarks fitted the pattern of escalating foreign pressure to force action by Japan. And, indeed, Prime Minister Nakasone instructed MOF to move to settle the problems before the group's next meeting.

One new issue did arise at the March session — Euroyen bonds. Treasury Department policymakers had moved liberalization of the Euroyen market to the front burner because they saw this as a potentially faster route to yen internationalization than battering away at domestic Japanese rules. At first glance it might seem odd that Tokyo had control over a market that was by definition beyond its

borders, but given MOF's influence over the domestic operations of Japanese institutions wishing to participate in the Euroyen market, it was able to exercise control.

The United States sought two things: changes in the regulations governing issues of Euroyen bonds and the elimination of the interest withholding tax on Euroyen instruments. MOF saw no easy solution to these demands. Japan's domestic bond market differed from those of other countries in that bonds unsecured by collateral were virtually unknown — Euroyen bonds would mostly be unsecured. Finance was worried that if the controls on Euroyen issues were relaxed or dropped, Japanese corporations would desert the home market to issue abroad, forcing the ministry to ease the regulations covering domestic issues of unsecured bonds to lure them back. More fundamentally, many MOF officials opposed liberalization of either the Euroyen market or domestic financial markets because these changes would ultimately affect the conduct of monetary policy. Some Americans, though, saw the problem less as control of monetary policy than a reduction in the power of MOF officials.

The Reagan administration also expressed dismay at the continuation of income tax withholding on interest payments from Euroyen bonds. So long as Japanese taxes were withheld on the instruments, contended U.S. officials, the bonds would remain unattractive. For its part, MOF was loath to make any change that meant less tax revenue.

The third round of yen-dollar talks, held April 16-17 in Washington, underscored the serious differences in perception of how the discussions were progressing. The Japanese participants felt the talks were quite successful. They had divided the substantive issues into three categories: those on which action was possible soon, those that required "further study" and those relegated to future consideration. Finance Vice Minister Tomomitsu Oba, the Japanese delegation leader, indicated after the meeting that the United States understood the problems faced by MOF in devising rapid changes in Japan's financial and capital markets, that the two sides were in substantial agreement on the issues, and that the only task left was to write the final report. In contrast to this rosy evaluation, Treasury Under Secretary Sprinkel reported that progress was less conclusive and that major problems remained.

As pieced together by knowledgeable observers in Japan, Washington and Tokyo were split over six specific issues. These were the removal of restrictions on medium- and long-term Euroyen bond issues; the elimination of withholding taxes on Euroyen bond interest payments; longer maturities for certificates of deposit; creation of a bankers' acceptance market; foreign participation in Japan's trust banking business; and foreign membership on the Tokyo Stock Exchange.

With the May 21 deadline for a final report fast approaching, MOF floated some compromise proposals. In regard to trust banking, the ministry indicated that foreign banks would be allowed to enter the market on their own, but not in partnership with Japanese securities firms, as many had planned (see below). Finance officials also suggested that they would study the Euroyen bond question, with an eye toward carrying out changes within one year. In addition, the ministry signaled its willingness to move ahead with the creation of a bankers' acceptance market.

Although several of these proposed moves fell short of Washington's demands, the Reagan administration decided to declare victory in the financial talks, in part to insure that Japan would not be a campaign issue in the November presidential elections. The report of the Joint Japan-U.S. Ad Hoc Group on Yen/Dollar Exchange Rates, Financial and Capital Market Issues was therefore released May 29 to great praise by both sides. While the document technically surveyed yen internationalization and foreign access to Japanese financial and capital markets, its importance lay in the concessions made by Tokyo in the process of writing the report. Treasury Secretary Regan hailed the final product as a great success: "I am pleased to say that the report being released today contains major new commitments and policy measures by Japan that we believe will, when fully implemented, redress many of the problems which have existed."

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The document covered changes Tokyo had already initiated or planned to introduce with regard to the Euroyen market, Japan's domestic financial and capital markets and access by foreign institutions to these markets. These changes, grouped by action status, are summarized in the accompanying box.

The Treasury Department claimed that over the long run these changes, if implemented, would imply a rise in the value of the yen. Japanese officials disagreed with this conclusion and warned the United States not to be disappointed if the increasing deregulation of domestic financial and capital markets caused a larger outflow of capital from Japan, thus depressing the yen's value. Events were to lend some credence to both sides.

Of greater importance was access: foreign financial institutions and nonfinancial corporations would have greater access to Japanese markets. The concessions won by Washington were only part of a process that began in the late 1960s. Still, they were highly significant because earlier changes had tended to leave control over the inflow and outflow of capital in the hands of Japanese financial institutions. With the May 29 yen-dollar agreement, however, that imbalance was expected to be at least partly redressed.

Mid-1984 Status Report On Financial Liberalization

Firm Concessions

1. The real demand rule for forward exchange-market transactions was dropped as of April 1, 1984, allowing purely speculative transactions in the market.
2. The designated company system restricting foreign investment in certain Japanese companies was abolished under legislation passed in May 1984.
3. The Japanese government obtained the authority under legislation passed in May 1984 to issue bonds denominated in foreign currencies.
4. The minimum allowable denomination for certificates of deposit was cut and the ceiling on the volume of CDs banks could offer was raised April 1, 1984.
5. Limits on currency swaps by foreign and Japanese banks were eliminated June 1, 1984. This change meant that banks could convert as much foreign currency into yen as they desired for use in Japan.
6. Guidance or control over lending abroad by Japanese banks was ended, including restrictions on the overall amount of loans, country limits and limits on participation in syndicated loans.
7. The ban on the sale of foreign CDs and commercial paper within Japan was lifted effective April 1, 1984.
8. Starting December 1, 1984, non-Japanese corporations, local and central governments, government corporations and international financial organizations will be allowed to issue Euroyen bonds with the same qualifications for issuers as in the *samurai* bond market, with no restrictions on the size of issues.
9. The guidelines for Euroyen bond issues by Japanese corporations were eased April 1, 1984, expanding the list of eligible issuers to about 90 companies.
10. Restrictions limiting the lead underwriters on Euroyen bond issues to Japanese financial institutions will be lifted effective December 1, 1984, allowing financial institutions of any country to perform this role.
11. The prohibition on Euroyen loans to Japanese residents was lifted June 1, 1984.
12. Foreign banks in Japan will be allowed to buy and sell Japanese government bonds in the secondary market. The Ministry of Finance expects to begin accepting formal applications within a few months.

Concessions Expected in the Near Future

1. A yen-denominated bankers' acceptance market will be established in 1985, structured according to recommendations to be completed in June 1984.
2. A further reduction in the minimum denomination of CDs is expected to be implemented in April 1985, along with another expansion in the maximum amount of CDs a bank can issue.
3. A new large-denomination deposit instrument is expected to be introduced with a market-determined interest rate.
4. The interest rate ceiling on large deposits is expected to be removed within two to three years.
5. Foreign banks in Japan will be allowed to engage in trust banking, but formal rules are not expected until the end of 1984; however, joint ventures in trust banking with Japanese securities firms will not be allowed.
6. By the end of 1984 it is expected that both foreign banks and Japanese banks will be permitted to issue short term (a maturity of six months or less) Euroyen CDs outside Japan.

Stalemate

1. The Ministry of Finance is adamant about applying the withholding tax to interest payments on Japanese bank deposits and securities held by nonresidents.
2. The same withholding tax will continue to be applied to interest payments made on Euroyen bonds issued by Japanese firms (but not on those issued by foreign organizations).
3. The ministry continues to resist suggestions from the Treasury Department that it expand the issuance of short-term Treasury bills as a means of broadening the maturity structure of Japanese government debt.
4. There has been no movement on the issue of seats for foreign brokerage houses on the Tokyo Stock Exchange. Tokyo promised to study the issue but warned that the exchange is a private organization.

Trust Banking One facet of Tokyo's financial liberalization plan moved right along: its decision to allow foreign banks to go after Japan's trust fund business. Previously the sole domain of Japanese trust banks and life insurance firms, this market was experiencing rapid growth, paced by widespread corporate adoption of pension plans. Given their experience with pension trusts in their home markets, foreign banks were expected to be significant competitors in Japan. Meanwhile, Japanese commercial banks, previously barred from managing trust funds, entered the market, albeit in an indirect manner for the time being.

Fleshing out Tokyo's May 1984 pledge to allow foreign banks to conduct trust banking operations, the Finance Ministry decided that foreign banks, joint ventures between foreign and Japanese banks and the domestic branches of foreign banks could move into the market. As expected, though, finance officials ruled out tie-ups between foreign banks and Japanese securities firms. This restriction dashed preliminary agreements between Japan's Big Four brokerage houses and four leading American banks — BankAmerica Corp., Chemical Bank, Citibank N.A. and Morgan Guaranty Trust Co.

MOF announced the criteria for licensing foreign banks to conduct trust fund activities at the start of 1985. It accepted applications through March based on the following criteria: the applicant had to be a bank; the bank should have extensive trust experience in its home market; and the bank should have greater corporate pension fund assets than the average Japanese bank (approximately ¥1.2 trillion). The applicant was also required to set up a separate wholly or jointly owned trust banking arm in Tokyo. At that time the ministry still planned to accept only eight foreign applicants, matching the number of domestic banks that would be allowed to enter the market (see Part III). The door was left open to further foreign participation, however, if additional domestic banks moved into the market.

MOF was faced with a bit of a dilemma when April arrived: six American banks — Bankers Trust Co., Chase Manhattan Bank N.A., Chemical Bank, Citibank, Manufacturers Hanover Trust Co. and Morgan Guaranty — plus three European banks had filed applications. All were highly qualified, meeting the capital, experience and institutional requirements with ease. Finance officials hinted through the press that they would like to approve all six American banks but only two European ones. This understandably set off lobbying efforts by the respective European governments, and in the end the ministry accepted all nine applications.

TSE Membership A rare opportunity for a foreign firm to purchase a seat on the Tokyo Stock Exchange appeared in late 1984. A merger among members of the Yamaichi Securities Co., Ltd. group created a vacancy that was to be filled in the traditional manner: a closed bid auction conducted by the firm vacating the seat. The Japanese subsidiary of Merrill Lynch & Co. jumped at the chance, offering a staggering ¥1.25 billion for the seat. Yamaichi came under heavy pressure from MOF to accept the American bid, but instead caved in to tradition and accepted a bid from an affiliated securities firm.

The decision caused some problems for the Finance Ministry since it was clear that Yamaichi officials had leaked Merrill Lynch's bid to its affiliate, prompting the company to raise its offer to ¥1.6 billion. The Merrill Lynch subsidiary declined to up its bid after being informed of the higher offer, saying that would set a bad precedent. The head office already considered the bid excessive, particularly since TSE memberships had gone for ¥150 million as recently as 1982. MOF was unhappy, although officials claimed that they had met the yen-dollar accord's stipulation that the ministry aid — not guarantee — foreign membership. U.S. negotiators, however, did not let the matter rest, bringing it up in negotiations throughout 1985.

Prodded by the government the Tokyo Stock Exchange issued final plans in late August 1985 to increase its membership by 10 seats to 93, opening the way for foreign securities firms as well as additional domestic brokerage houses to participate in the world's second-largest stock exchange. A total of 10 foreign and eight domestic securities companies vied for the new memberships. In late November the TSE elected six of the foreign applicants — Merrill Lynch International Bank Inc., Goldman Sachs International Corp., Morgan Stanley International Ltd. and three British brokerage houses.

The ¥1 billion to ¥1.2 billion price tag of each new seat, although less than what Yamaichi's affiliate had paid in 1984, was still viewed as high by the foreign firms — high enough to insure that operations would not be immediately profitable. Nonetheless, major foreign brokerage houses considered a TSE seat crucial to their long-term success, especially with 24-hour trading on the horizon. Whether the foreign brokers could break the hammerlock on trading held by Japan's Big Four securities houses was an open question, however.

Yen-Dollar Follow-Up Six months after the announcement of the yen-dollar accord, American and Japanese financial officials met in Tokyo to evaluate its impact. Treasury Under Secretary Sprinkel followed the by-then familiar pattern of U.S.-Japan negotiations. He led off with glowing praise for Tokyo's willingness to undertake the reform of Japanese financial and capital markets and the progress to date, and then moved quickly to criticize a host of outstanding issues. In a speech given at the close of the late November meeting, the Treasury official stated that he was "very pleased with the [Finance] Ministry's

implementation of policy changes in some areas of our agreement." While those areas were not identified, Mr. Sprinkel was not so reticent when it came to elaborating the points still at issue.

Touching briefly on the three main goals of the yen-dollar report, Mr. Sprinkel contended that Tokyo had not done enough to liberalize domestic capital markets or the Euroyen market and that it was still reluctant to provide full Japanese market access to foreign financial institutions. In addition, he listed 10 specific points "where much further progress is needed." These covered domestic interest rate deregulation, new financial instruments, the bankers' acceptance market, financial accounts held by residents abroad, licensing requirements for issuers of Euroyen bonds and certificates of deposit, eligibility standards for yen bond issues, syndicated Euroyen lending, overseas yen lending, trade in government securities and trust banking.

Finance Vice Minister Oba responded to this grocery list by assuring the United States that its views would be taken into account but added that Washington should not expect all its ideas to be incorporated. He stressed that many policies were still under discussion by the ministry and that the reforms required alterations in several Japanese financial laws, making caution a necessity.

The yen-dollar agreement came up for a second review in late June 1985 during a meeting between Treasury Secretary Baker and Finance Minister Takeshita. Both sides skirted the fact that the dollar had weakened considerably since the agreement was initiated, mostly due to the large outflow of Japanese capital in search of higher returns. At the same time, however, the fact that foreign access to Japan's financial and capital markets had increased was highlighted. To further the process Mr. Takeshita announced that his ministry would permit all nine foreign banks that had applied for trust banking licenses to begin business (see above). He also hinted that the Tokyo Stock Exchange was moving to open the way for foreign membership.

During subsequent subcabinet-level talks Finance's Mr. Oba unveiled additional liberalization steps. In particular, he presented a timetable for deregulating interest rates on deposits ranging from ¥100 million to ¥1 billion and outlined plans to reduce the minimum size of money market certificates and allow a wider range of maturities on CDs. The reaction of the American delegation to these planned changes was unusually restrained given the fact that the interest rate liberalization schedule, for example, stretched well into 1988.

The Reagan administration renewed its offensive to encourage Japan to move rapidly to liberalize its financial and capital markets in December 1985. Assistant Treasury Secretary for International Affairs David Mulford urged Japanese officials to quickly make major changes in the banking, equity and debt markets to promote the internationalization of the yen. Although Finance Ministry officials were caught off-guard by the open criticism, they defended the deregulation program by pointing to several developments ignored by Mr. Mulford.

The Treasury official was in Tokyo for a meeting with his counterparts to review the impact of the Group of Five's September 1985 agreement on exchange rates (see Part III). Notwithstanding the yen's steady advance against the dollar in the intervening months, Washington's impatience with Japanese efforts to change fundamental economic factors boiled over. At a post-meeting news conference, Mr. Mulford was cynical about Tokyo's sincerity, claiming that he "saw little evidence of intensified efforts" by MOF to deregulate domestic markets and internationalize the yen.

The U.S. negotiator asserted that MOF still retained too many market controls, which he claimed continued to limit access to Japanese financial resources and inhibit the yen's acceptance as an investment currency by foreign buyers. The ministry's regulation of the interbank overnight and short-term government bond markets and its strict limitations on the Euroyen market came in for particular criticism by Mr. Mulford. At another point he said that Tokyo lacks "the concept of free, liquid and deep [financial] markets." The American Christmas list also included: accelerated liberalization of deposit rates; elimination of controls on the interbank overnight market; relaxation of restrictions on the trading of government bonds and on the entry of foreign banks into this market; longer maturities for Euroyen instruments; and deregulation of the Euroyen market.

Mr. Mulford's counterpart, Finance Vice Minister Oba, responded by saying that Tokyo was accelerating some parts of its deregulation plan, but maintained that the U.S. suggestions were simply too much too fast. In many cases, he warned, controls could not be lifted overnight because it would lead to chaos. In other instances, he said, Japan had eased regulations only to have the impact nullified by events beyond its control. The vice minister also pointed out that Mr. Mulford's own suggestions were contradictory. The United States, he noted, wanted Tokyo to relinquish certain reins, but on the other hand was urging the Finance Ministry to make Japanese brokerage houses behave in overseas markets, to cite just one example.

In retrospect Washington's constant criticism of the pace of financial liberalization in the mid-1980s was probably unavoidable. Since the Finance Ministry's guiding principle in implementing deregulation was to avoid "disruption" of domestic markets, an incremental approach to reform became standard operating procedure. This meant that changes were small and widely spaced. Yet the fact remained that change

was occurring — a movement the Reagan administration had to applaud, whatever its reservations about the pace.

MOSS Talks

Having passed its field trial in the 1984 financial liberalization discussions, the sectoral negotiating approach was put to a new, more critical test in 1985. At their January 2 meeting in Los Angeles, President Reagan and Prime Minister Nakasone endorsed a series of high-stakes market access negotiations, christened the MOSS talks, in an attempt to contain the building momentum on Capitol Hill for protectionist legislation. Selected for initial discussion were four product areas — telecommunications equipment and services, medical equipment and pharmaceuticals, sophisticated electronics and forest products. These targets had two characteristics in common. For one, American suppliers were unquestionably competitive in the international market, yet they had had trouble making sales in Japan. In addition, market access problems in each of these product areas had been the subject of previous bilateral negotiations.

Subcabinet-level officials from the United States and Japan met in Tokyo January 29-30 to work out procedural details for the sectoral talks. Instead of the fast start both sides anticipated, the two delegations got bogged down parrying over the causes of the soaring bilateral trade deficit. Finally turning to Washington's objectives for the MOSS negotiations, Under Secretary of State for Economic Affairs W. Allen Wallis reiterated that the United States was looking for change not only in government-created or government-sanctioned barriers to trade, but also in such private-sector institutional or structural factors as the Japanese distribution system and the corporate buy-national psychology. The U.S. delegation leader stressed that Washington was not interested in piecemeal change — specifically another market access package; rather, it expected a complete overhaul of the "laws, regulations, institutions and customs that could impede free access for foreign suppliers." Since its goals were so sweeping, the United States was not going to set formal deadlines for the negotiations, Mr. Wallis said. He made clear, however, that the Reagan administration expected steady progress, particularly on the high-priority issue of market opportunities for U.S. suppliers of telecommunications equipment and services.

Telecommunications Equipment and Services

By the time the MOSS talks were launched, U.S. trade negotiators had spent the better part of a year trying to insure that American suppliers of telecommunications equipment and services would have the same access to Japan's soon-to-be-deregulated market as their Japanese competitors. As discussed in Part III, Washington's initial concerns centered on two parts of the draft deregulation legislation unveiled by the Ministry of Posts and Telecommunications in early 1984 — foreign ownership ceilings on companies providing services and registration regulations for firms interested in the market for computer communications systems, known in Japan as value-added networks.

Pre-MOSS Talks MPT's deregulation proposal divided market participants into two groups. Businesses that owned their own communications circuits would be classified as Type I firms or common carriers. A license from MPT would be required and foreign investment in the firm would be restricted to one-third of the total capital. Businesses that leased telephone circuits for VAN use would be classified as Type II companies and further classified by the size of their VAN. Type II firms providing large-scale VAN services (Special Type IIs) would need a MPT license to operate just as Type I firms would, but in principle these businesses could have up to 50 percent foreign ownership. Companies offering more limited VAN services (General Type IIs) would only have to notify MPT of their intent to operate and could be completely foreign owned.

The possibility that American companies might be effectively barred from a big part of the Japanese market for a service with such great potential as VANs sparked cries of protection from U.S. government and industry. VAN systems were first developed and employed in the United States and American companies held a clear competitive advantage in this field. The Reagan administration claimed that free trade in the telecommunications field was much more important to Japanese firms than to U.S. companies. Trade negotiators noted that if the restrictive legislation proposed by MPT was adopted, Japan risked being barred from the deregulated American market. U.S. officials did not dispute Japan's right to regulate its telecommunications market, but repeatedly warned of adverse consequences if Tokyo implemented the ministry's proposal.

In mid-March Posts and Telecommunications Minister Keiwa Okuda said his ministry's proposed restrictions on VAN market entry by foreign-owned firms would be reviewed. Saying he agreed in principle with the United States that access to the secondary services market should be liberalized without prejudice to overseas competitors, Mr. Okuda promised flexibility on the ownership issue. Concerning the primary services market, however, he said Japan must restrict foreign ownership for national security reasons.

Despite these signs of compromise, the March 27 deadline for submission of non-budgetary legislative proposals to the Diet came and passed without final cabinet agreement on the deregulation draft. The primary obstacle was MPT's continued insistence that Special Type II businesses should be subject to licensing. The Ministry of

International Trade and Industry, which had been battling MPT at almost every turn in the domestic debate over the draft legislation, remained strongly opposed to any red tape that might impede access to the VAN market. For its part, the American government kept pushing for minimal reporting guidelines for firms wishing to enter the secondary services market in order to secure unhindered access.

Attempting to find a middle ground, Keidanren (Japan Federation of Economic Organizations) suggested the establishment of a simple reporting system for secondary services businesses for a trial five-year period. Its compromise proposal also contained several other provisions of interest to foreign firms. Most importantly, there would be no restrictions on foreign ownership of firms wishing to enter the secondary services market. At the same time, though, new common carriers would be limited to firms with no more than one-third foreign ownership. (This provision was acceptable to the United States, which had similar requirements for national security reasons.)

When the compromise proposal was presented, the U.S. government claimed success in its efforts to preempt protectionist legislation in Japan. But on April 5, the day before the cabinet was to formally endorse the compromise, U.S. Ambassador to Japan Mike Mansfield was instructed to pass on official U.S. objections to particular provisions of the draft legislation. The principal problem in American eyes was that sections concerning the denial of entry into the market were much too vague and could be used by MPT to exclude American firms.

Tokyo was rather surprised by the last-minute American objections, especially in light of earlier positive statements from Washington. The language of the proposed deregulation bill was nothing unusual from the Japanese standpoint; other laws contained wording nearly identical to that criticized by the Reagan administration. Moreover, the compromise was not easily crafted, and there was still some unhappiness over its provisions within both MPT and MITI. For example, one controversial article stipulated that the entire act would be reviewed three years after it came into effect on April 1, 1985, meaning that the whole question of a licensing or registration system for companies interested in the secondary services market could resurface.

The government decided in April to submit the deregulation bill to the Diet as part of a package that included legislation to reorganize Nippon Telegraph and Telephone into a semi-private company, and in the meantime try to reassure the United States that the implementing regulations would be fairly administered. After failing to gain Diet approval for the package during the regular session, which was extended to early August, Mr. Nakasone put it at the top of the legislative agenda for the December session. This time around the telecommunications reform bills were passed quickly.

Countdown to Deregulation Specific American goals in the telecommunications equipment and services area shifted as Tokyo moved from the planning phase to the implementation stage of the deregulation process, but the Reagan administration continued to sound the same two themes at the negotiating table. First, Washington sought the greatest possible degree of national treatment for foreign firms. Since Japanese suppliers in the United States received the same consideration as domestic manufacturers, U.S. trade officials expected Tokyo to adopt the identical standard. Second, the government's control over the deregulated market must be held to a minimum. In view of the Japanese bureaucracy's reputation for being paternalistic and wary of foreign influences, controls should be as limited as possible, American policymakers argued.

- Certification procedures - One of the first issues Commerce Under Secretary Olmer, the chief U.S. telecommunications negotiator, raised in the MOSS talks were MPT's proposed equipment certification procedures. Washington sought assurances that these procedures would be administered fairly and that safeguards would be established to protect proprietary information. American trade officials also requested that foreign companies be represented in the independent certification organization that would approve telecommunications equipment for sale when deregulation took effect.

Of greatest concern to the Reagan administration was MPT's plan to institute a dual-equipment certification system whereby NTT would have self-approval power over the telecommunications equipment it sold but all other vendors would have to win approval from a separate institution. American negotiators argued that this system would give the privatized NTT a significant edge over the competition. They also claimed that it would erect a nontariff barrier around a market where U.S. companies were expected to be highly competitive — a situation diametrically opposed to the access Japanese companies had in the U.S. market.

Additionally, MPT's failure to include provisions for type certification of equipment was a sensitive issue since Washington considered this omission a step backward. Furthermore, it was possible that a single piece of equipment would have to obtain as many as five approval seals in order to be marketed in Japan. The U.S. negotiating team considered this far more complex than the then-existing requirement for one approval seal from NTT and expressed concern that it enlarged opportunities for discrimination against foreign companies.

After innumerable rounds of drawn-out talks lasting until mid-March, MPT addressed these concerns one by one. To allay American concerns about the independence of the organization responsible for equipment certification, the ministry scrapped its original plan to put Japanese telecommunications industry executives in charge of the actual approval process. The new agency, the Japan Approvals Institute for Telecommunications Equipment, was given sole authority to approve all telecommunications equipment for sale in Japan, including that marketed by NTT. MPT also reduced the number of approval seals that a piece of equipment had to have to two at most: one from JATE and one showing it met Japan's electrical safety regulations. Moreover, while type certification of telecommunications equipment was not included in the deregulation law, MPT negotiators agreed to provide the functional equivalent for all manufacturers.

- Testing - MPT's administrative guidelines covering testing were another early American target in the MOSS sessions. The U.S. side sought to minimize the length of the approval process and the possible leakage of proprietary data by asking Tokyo to accept foreign test data. Ministry policymakers initially rebuffed this demand but finally agreed to accept testing results from any manufacturer, foreign or domestic, making self-certification possible. MPT's original plan for prototype testing was also dropped, a gesture toward foreign companies worried about being forced to divulge proprietary information.

- Standards - Washington also took issue with MPT's proposed standards for telecommunications terminal equipment (also known as customer-premises equipment), which went into far too much detail for U.S. officials. Things such as the sound of the ringer, voice volume and tone, and even outer appearance were included, reducing room for companies to differentiate their products. The Japanese negotiating team, headed by MPT Vice Minister Moriya Koyama, argued that such standards were necessary to insure proper quality since the public expected MPT to safeguard its interests. American officials were unimpressed, saying that the consumer should be able to decide for himself what was acceptable and that such requirements could easily become a nontariff barrier.

Under pressure from the Reagan administration, the ministry agreed in mid-March to reduce the number of technical standards for terminal equipment from 53 to 30, bringing them more in line with U.S. standards, which are limited to those required to protect the communications network. Japanese specifications for adequate voice quality and cross-talk suppression were the major departures from U.S. standards, although Washington observers said that Tokyo still had a long way to go before its standards were as simple as this country's.

- Transparency - Another constant American theme in the early MOSS negotiations was the lack of transparency in the standards-drafting process. In response, MPT scheduled hearings on technical standards for terminal equipment. Representatives from public and private foreign and domestic organizations were invited to testify at the month-long series that began in mid-January. The ministry also agreed to establish a liaison channel with the American Chamber of Commerce in Japan to handle complaints about testing and certification procedures.

A transparency problem of a different sort surfaced when U.S. government and industry officials became irked by MPT's refusal to distribute copies of its draft implementing regulations. While this was standard procedure for the Japanese government, the United States insisted on seeing the actual drafts before rendering a verdict. In an extraordinary step to reassure foreign parties, MPT Minister Megumu Sato agreed to release a summary of the draft ordinances by March 7 and to hold subsequent consultations with U.S. officials.

Tokyo also pledged to actively seek foreign views on standards and to improve adherence to the standards notification procedures outlined in the General Agreement on Tariffs and Trade's standards code. In a parallel move, MPT agreed to establish an appeals system and to consult with the Foreign Ministry and the U.S. Embassy on an appeals process outside of its jurisdiction. On another issue of interest to the United States — foreign participation in the policymaking Telecommunications Advisory Council, ministry officials noted that this role was prohibited by law, but they indicated a willingness to consider improved foreign access to the council, perhaps by naming Japanese nationals employed by subsidiaries of foreign companies.

- Regulatory categorization - The old issue of the regulations governing the structure of the deregulated services market also resurfaced in the MOSS negotiations. To recap, the law opening this market to competition divided companies into two groups: firms that owned transmission circuits (Type I) and businesses that leased circuits (Type II). Foreign control was only permitted for Type II firms, with that category further subdivided into two based on technical specifications. More rigorous controls covered Special Type IIs (companies that used more than 500 circuits, each with a capacity of at least 1,200 bits per second), although these firms provided the same value-added services offered by General Type IIs.

The Reagan administration took the position that no additional registration requirements should be imposed on Special Type II companies and that approval of their operations should be made automatic. American negotiators also argued that the distinction between Special and General Type II firms based on the number of circuits and on the

nature of the company's customers was artificial and should be eliminated.

Although MPT negotiators repeatedly told their American counterparts that Tokyo could not eliminate the distinction between Special and General Type II firms because it was mandated by law, they hinted that this division would be reviewed after three years. In the meantime, the ministry simplified the registration requirements for Special Type II businesses and made the approval process quicker and more automatic. With regard to the definition of "large-scale" services, Japanese officials pointed out that the limit was very high: a company would have to have a network similar to those of Tymnet Inc. and GTE Telenet Communications Corp. to be classified as a Special Type II.

- Post-reorganization NTT - Although issues connected with foreign access to the soon-to-be-deregulated Japanese telecommunications market dominated the agenda of the early rounds of MOSS talks, Washington did raise questions about some aspects of the pending reorganization of NTT into a semi-private corporation. One concerned the possibility that the new NTT might use revenues from regulated services to subsidize non-regulated activities. MPT officials ruled out this scenario, saying that strict accounting procedures would be enforced to prevent cross subsidization.

U.S. officials were also worried that privatization would free NTT from adherence to the recently renewed 1981 agreement that had opened its procurement process to foreign suppliers (see below). Washington's doubts on this score were put to rest in late January when Tokyo agreed that NTT would respect the purchasing pact through 1988.

Post-Deregulation Talks By the time the Japanese market for telecommunications equipment and services was opened to competition on April 1, Tokyo had agreed to implement a long list of steps to insure nondiscriminatory treatment of foreign companies in the deregulated market. The Reagan administration could have justifiably declared victory at this point. Even hard-liners acknowledged privately that Washington had won 90 percent of what it sought. Moreover, action was still possible on at least one of the three issues left on the negotiating table since the Japanese government had promised to review its already simplified technical standards for telecommunications terminal equipment to see if they could be pared down mainly to those designed to prevent harm to the network.

This review produced some surprising results. In late April MPT said it would completely eliminate nine of the 30 remaining technical standards, including those applicable to voice quality and signal strength, and delete part of another. The ministry also agreed to include clearer guidelines with regard to cross-talk in the wire tap regulations and to quantify acceptable levels of cross-talk. Other proposed changes involved clarification of the regulations affecting six additional standards, such as drawing up equipment-network connection specifications in a transparent manner. "Equity will exist in the regulatory process" American negotiators concluded after being briefed on MPT's plan.

MPT also agreed in late April to enforce procedural transparency on the reorganized Nippon Telegraph and Telephone Corp. and new common carriers with regard to interface protocols. Going a step further, the ministry said common carriers would have to include in their tariff schedules all information pertaining to their network's requirements for attaching terminal equipment. This regulation, officials said, would prevent a carrier from disclosing the necessary data only to selected equipment suppliers. To enhance access to the development process for interface protocols, MPT agreed to cooperate in establishing a private advisory organization that would include foreign participation. Along with its other work, this body would review MPT's demarcation line between the network and terminal equipment.

Because of the importance of international telecommunications networks to foreign and domestic companies alike, Tokyo agreed to apply these transparency requirements to Japan's public international telecommunications monopoly, Kokusai Denshin Denwa Co., Ltd. This was good news for companies like Tymnet and GTE Telenet that planned to set up international value-added networks.

Having gained a compromise on technical standards and several other leftover issues involving terminal equipment, American officials turned their attention to a completely new area — the lucrative mobile telephone market. During the first round of MOSS talks on this subject, held in early June, the U.S. side identified three problems: Japan's licensing and approval procedures for radio equipment; its refusal to accept radio equipment test data from foreign manufacturers; and the procurement policies of public agencies. More specifically, administration officials said they wanted MPT to bring Japanese standards for cellular telephone systems into line with American or European ones; improve general access to Japan's radio gear market for broadcast and reception equipment; and end the "buy Japan" policies followed by public agencies such as the Police Agency.

Unlike the cable-borne telecommunications market, communications via radio waves were not included in the administrative reform proposal that had served as the blueprint for Prime Minister Nakasone's deregulation campaign (see Part III). Without this consensus, MPT was unsure how to approach deregulation of this market. It was clear, however, that Japan's Radio Law needed to be brought up to date.

Passed in 1950, the law created a Radio Bureau with the power to assign frequencies, set standards and approve equipment. While the system kept pace with developments in the 1950s and 1960s, it had fallen behind technology's rapid advance since the last revision in 1971. The resulting absence of standards for state-of-the-art equipment prevented U.S. companies from selling several products in Japan, including message-displaying pocket pagers, radios that patch into existing telephone lines and fully portable telephones.

Standards were only part of the problem. Foreign manufacturers could not self-certify that their equipment met Japanese standards; instead, they had to submit products to a certification panel that had personnel links with major Japanese electronics makers. Moreover, while the law allowed for type approval of 12 classes of wireless equipment, the products of greatest American interest — cellular telephones, pocket pagers and remote terminal equipment — were not included.

While MPT was willing to consider the Reagan administration's complaints, it quickly became obvious that Tokyo and Washington would have trouble duplicating the highly successful negotiations on cable-based equipment. As late as the end of October, ministry negotiators were depicting most of the concessions on wireless equipment demanded by the United States as impossible in the short run. But in a late November about-face that took Washington by surprise, Tokyo promised action on virtually all of the points raised by the United States.

For starters, MPT agreed to accept manufacturer-submitted data for radio equipment approval and to reduce the number of technical standards for radio equipment basically to those necessary for interference control and efficient spectrum use. The ministry promised as well to insure the impartiality of the organization responsible for certifying radio equipment for sale in Japan and to provide a window so that vendors could obtain information on radio equipment technical standards and frequencies and receive assistance on starting the approval process. Other steps outlined included expanded opportunities for foreign individuals or companies to obtain radio station licenses for a variety of land mobile radio services and the acceptance of duly qualified foreign radio operators. Finally, MPT said it would formulate technical standards and allocate spectrum for cellular telephones with an eye toward broadening market opportunities for new entrants.

Tokyo's eleventh-hour concessions on wireless equipment gave the Reagan administration ample grounds for declaring the MOSS negotiations on telecommunications equipment and services a success. In off-the-record comments, in fact, trade policymakers admitted that the talks had succeeded beyond all expectations.

Electronics The MOSS negotiations on improved market opportunities in Japan for American suppliers of electronics products got off to a much slower start than the talks on telecommunications equipment and services, in part because there was no fast-approaching deadline like the April 1 deregulation of the Japanese telecommunications market to spur action but also because Washington did not have a ready-made agenda. By early March, though, the Reagan administration had drawn up a list of nine discussion points, two of which — protection of computer programs and semiconductor designs — had been the focus of bilateral debate in 1984. But even with a shopping list in hand, U.S. negotiators frequently had trouble framing their requests. Tokyo therefore was often puzzled as to how to respond.

Software Protection The 1984 debate in Japan over how to protect computer software proved to be unusually contentious (see Part III). So was the trans-Pacific debate as Washington pressured Tokyo to adopt a legal regime similar to the American one. By the time the MOSS talks on electronics started, the Japanese cabinet was on the verge of approving amendments to the Copyright Law to provide program authors rights similar to those granted U.S. programmers. The Reagan administration, however, used the new negotiating forum to insure that the legislation was in fact adopted by the Diet and to keep tabs on how the implementing regulations were being drafted.

The battle over how to protect software was actually fought between the Ministries of Education and International Trade and Industry. Washington, however, was instrumental in the Education Ministry's victory since it backed the MOE approach. The way the United States handled this issue also signaled a Reagan administration innovation in bilateral relations — preempting Japanese legislation perceived as inimicable to foreign interests.

In late January 1984 a MOE advisory council recommended that Japan's Copyright Law be amended to give computer programs the identical protection accorded literary works — an approach similar to the one adopted by the United States. This recommendation was at odds with an early December 1983 proposal by the Ministry of International Trade and Industry that would have created a new legal system to protect software. Not only would the period of protection be significantly shorter than under the MOE plan (17 versus 50 years), but software authors would also have to divulge publicly more information about their programs. In addition, MITI planned to give itself the power to force a programmer to disclose the contents of his program, a provision the United States interpreted as forced licensing. It was this MITI proposal that galvanized the Reagan administration into action.

Strong objections were lodged against two aspects of MITI's proposal: the brevity of protection and the mandatory

disclosure rules. Because the Education plan closely resembled the U.S. procedure for safeguarding software (copyright protection for 75 years), American officials lined up behind it. Analyses by American lawyers specializing in computer law argued that to create a special domain for software, as the MITI proposal would, ran counter to established principles of intellectual property and could act as a disincentive to foreigners exporting state-of-the-art software to Japan, as well as inhibit domestic investment.

Faced with continued resistance by MITI, American officials in late February hinted at retaliatory measures if the MITI approach was adopted. While MITI officials were saying just earlier that month that they would not give ground on this issue, some backpedaling took place. An extension of the 15-year span of protection was seriously considered and strict abuse-preventing guidelines were discussed for the very controversial mandatory licensing system. From the American viewpoint, however, a "fundamental philosophical difference between American and Japanese concepts of software" existed — a difference that proved difficult to erase.

Deputy Assistant Secretary of Commerce for International Economic Policy Clyde Prestowitz restated American concerns in early March, but took a slightly different tack on what the United States would consider acceptable. Compliance with international copyright agreements was the yardstick against which the Japanese proposal would be measured, he warned. While this represented a softening of the American position, it would still require MITI to significantly alter its proposal in terms of the length of protection offered. Third-party rights were also "more liberal" than international practice, Mr. Prestowitz said in a muted reference to MITI's controversial mandatory licensing provisions.

Inter-ministerial negotiations came to a standstill in mid-March. MITI refused to withdraw or satisfactorily alter its proposal. The ministry unabashedly claimed that its plan was more appropriate for the dynamic software market and that critics did not understand its good intentions. MOE kept its head down but argued behind closed doors for adoption of its proposal. With MITI officials adamant, MOE personnel felt that it would take involvement at the highest political level to move discussions off center in time for the March 27 deadline for submission of non-budgetary bills to the regular 1983-84 Diet session. As matters developed, this deadline came and went with the two ministries still deadlocked.

Although Diet consideration of software protection was not possible for at least another nine months, behind-the-scenes maneuvering by MITI and MOE continued unabated. So did pressure from the United States. In late August Deputy U.S. Trade Representative Michael B. Smith reiterated U.S. opposition to MITI's proposal. Mr. Smith singled out three areas: the length of protection, compulsory licensing and the extension of protection to source code.

The mention of source code pointed up a possible new point of disagreement. Source code, the special language executable and directly understood only by computers, does not meet the traditional standards for qualification as a piece of literature for copyright purposes. In the United States, the source code is covered by copyright laws because it is a language employed by writers. No such practice had developed in Japan, and U.S. officials seemed to be concerned that the MITI proposal would not give source code equal protection. Japanese representatives assured the U.S. negotiator that Tokyo intended to provide full protection for software and that the point of dispute was how to do it.

MOE's way finally prevailed. In mid-March 1985 the ministry unveiled a legislative draft identical to its initial proposal with one exception: software users could alter a program to meet individual needs and copies for personal use could be made without the permission of the copyright holder. This change as well as some modifications in the registration procedures were MOE's sole bow to MITI.

The amendments to the Copyright Law proposed by the Agency for Cultural Affairs, an arm of MOE, were approved by the cabinet in early April and passed by the Diet two months later. The amendments provided program authors rights similar to those granted U.S. programmers, including 50 years of protection. Moreover, there was no provision for compulsory licensing. As with all Japanese laws, though, the implementing regulations to be drawn up by MOE would heavily influence the quality of protection. This, in fact, was the main reason the Reagan administration included software protection on its MOSS agenda.

Semiconductor Design Protection Washington similarly used the MOSS forum to track the progress of Japanese legislation to protect the designs of integrated circuits. Drafted by MITI, the measure was patterned after this country's Semiconductor Chip Protection Act of 1984, which was approved by Congress in early October. SCPA established a new legal domain separate from traditional copyright law to protect semiconductor designs for a period of 10 years. The Secretary of Commerce was authorized to extend the bill's protection to a foreign company if the government of that country was working toward a similar law; if that country had not recently engaged in microchip piracy; and if granting such an extension would achieve international comity. Reverse engineering of protected designs was permitted for the purpose of "teaching, analyzing or evaluating the concepts or techniques embodied in the [design]."

The draft legislation recommended in January 1985 by a MITI advisory commission was designed to provide the same *sui generis* protection for semiconductor layouts as the U.S. law and for an identical 10-year period. Similarly, the advisory group proposed that only designs be protected, not the ideas they embodied, and that the study of protected designs be allowed to promote competition. There were differences, however, between the Japanese draft and the American law, particularly in the areas of design-right recognition and administrative procedures.

In the end protection for semiconductor designs in Japan turned out to be a non-issue in bilateral relations since the bill approved by the Diet's lower house in mid-April and the upper house in late May was essentially a copy of the U.S. legislation. The measure granted exclusive commercial rights to original chip designs for 10 years effective January 1, 1986 and provided criminal penalties for violators as of the same date. While similar to patent law in that developers could seek damages for infringement, the new law was not to be administered by Japan's Patent Office but by MITI.

The Japanese legislation received an indirect endorsement from the U.S. government when the Department of Commerce's Patent and Trademark Office decided in early June to grant Japanese applicants interim protection for IC designs under the Semiconductor Chip Protection Act. While noting that "the Japanese bill is not as specific as the U.S. legislation and that implementing regulations will be important in determining how the law will work in Japan," PTO opted to provide coverage to Japanese layouts for one year. If Tokyo's legislation and implementation proved satisfactory, the president could issue a permanent proclamation granting reciprocal rights, but if problems cropped up, Japan had until early November 1987 to come up with an acceptable system. Japanese mask works successfully registered during the one-year interim period, however, were valid regardless of the administration's final decision on Japan's protection system.

Other Issues The seven other discussion points on the U.S. agenda for the MOSS talks represented a grab bag of issues. For example, there was a great deal of give-and-take on the subject of tariff reductions on electronics products. Washington originally suggested that the United States and Japan cut duties on computer equipment, but Tokyo countered in mid-March with a proposal that both countries eliminate or lower tariffs on approximately 40 products as a follow-up to the removal of duties on semiconductors. Not waiting for the United States to act, the Japanese government announced in late June that it would cut the tariffs on a long list of electronics products of interest to the United States by 20 percent in 1986 and eliminate the duties on certain types of telecommunications equipment at that time as well. It also agreed to remove the tariffs on computers, peripheral equipment and parts if Washington eliminated its duties on computer parts.

Faster processing of patent applications was another U.S. goal in the MOSS talks. Apocryphal tales of U.S. firms waiting years for patent approval were commonplace and had developed into a source of ill will. Japanese negotiators produced data showing that the average time required for patent approval was roughly similar to that in the United States. U.S. negotiators were not impressed by these claims of efficiency and continued to press the issue. Another point of contention was the length of time rival companies had to examine and comment on a competitor's patent application before it was approved. Foreign firms felt that this gave away too much to Japanese rivals. Tokyo eventually agreed to expedite and improve its patent process, mainly through computerization, but these changes had not been implemented by the end of 1985.

An old issue also appeared on the agenda: foreign participation in government-funded research and development programs. MITI-coordinated programs in the computer and semiconductor fields were widely credited in the United States with developing first-class Japanese competitors. With Japan moving into numerous other high technology areas, including new materials, biotechnology and optoelectronics, foreign firms were very interested in participating in various government-industry research projects. Pressed on this point, Japanese negotiators reiterated their offer to consider requests from foreign companies with research facilities in Japan, but the U.S. side again rejected this proposal as too restrictive. By late summer Tokyo had agreed to let several foreign firms participate in a five-year software development project that was just getting under way. What was left unclear, however, was whether foreign firms would be included in future programs.

The United States also tackled another longstanding problem when it sought foreign participation in the development of industrial standards and regulations. At first Tokyo argued that mechanisms for foreign input were already in place, but Washington, drawing on the experiences of American standards-setting groups, continued to assert that these arrangements were not working. As part of its July "action program," Tokyo finally pledged to give foreign companies complete access to the official standards-drafting and standards-revision process.

The July market access package also included a pledge to authorize more U.S. testing laboratories during FY 1986 to check and certify products for Japanese markets — another item on the U.S. agenda. Three U.S. testing firms, including Underwriters Laboratories Inc., had earlier been authorized to conduct certifications in a narrow range of products or perform recertification inspections.

U.S. negotiators also took aim at Japan's bureaucracy in another area — customs procedures. Washington wanted MITI to delegate authority to approve imports of electronics products to Customs agents so that customs and regulatory inspections could be performed at the same time. Ministry officials said they would consider this suggestion, but no progress had been made by year-end. In contrast, the Ministry of Finance took care of the ninth complaint on the U.S. list in late summer when it eliminated the procedure required for foreign exchange transactions involving equipment upgrades and products re-imported into Japan after being repaired abroad.

By the end of 1985 Washington could put check marks next to most of the items on its original agenda for the electronics talks. It could also cross off U.S. access to the Japanese semiconductor market, one of the additions to the list, since this problem was being discussed outside the MOSS framework (see below). That left just a few issues on the table. One — the import-dampening impact of Japan's complex distribution system — could not be resolved by the government, while another — Tokyo's satellite procurement policies — was regarded as non-negotiable by the Japanese side.

Medical Equipment and Pharmaceuticals The issues making up the Reagan administration's agenda for the MOSS negotiations on medical equipment and pharmaceuticals were familiar since they had been discussed for more than two years within the framework of bilateral consultations on standards, testing and certification procedures. Heading the list was the longstanding demand that Tokyo accept foreign clinical test data as the basis for registering drugs and medical devices developed overseas. Here Washington's persistence finally paid off.

Effective July 31 Japan agreed to accept the results of clinical trials conducted in other countries as the basis for registering new pharmaceuticals; the only exceptions were three types of test data that might be affected by racial differences. As of the same date, moreover, Tokyo said it would accept foreign clinical test data for medical devices and in vitro diagnostic reagents. There was only one caveat: local testing might be required for implantable devices and diagnostic agents that cause immunological reactions.

By agreeing to accept foreign clinical test data for reagents that are not affected by racial differences, Japan addressed part of the U.S. demand for speedier approval procedures for in vitro diagnostic reagents. In addition, a different administrative process for approving reagents was introduced July 31, which split them off from new drug applications. Moreover, the Ministry of Health and Welfare said it planned to overhaul the classification system for reagents, with the goal of developing a system similar to that used by the Food and Drug Administration.

The United States was less successful in gaining greater transparency in the approval process for pharmaceuticals and medical devices. Negotiators had sought consultations between the applicant and the Central Pharmaceutical Affairs Council at three points: when an application was submitted, after the pre-clinical test data had been reviewed and at the end. As part of the July 31 market access package, Tokyo said that companies applying for product approval would have the opportunity to communicate directly with the council, but it was acknowledged that these contacts would be more limited than what Washington had in mind.

Responding to complaints by American manufacturers that MHW sat on their applications for approval of new pharmaceuticals and medical devices to give Japanese competitors time to develop the same product, the Reagan administration pressed the ministry to set deadlines for the approval process. MHW bowed to this demand in mid-summer. Similar to Food and Drug Administration procedures, the new system would give MHW flexibility when deadlines could not be met but also required the ministry to provide explanations in such cases.

Tokyo acted as well on Washington's demand for a simplified system of product reapproval in situations where a manufacturer of medical equipment made minor product modifications that did not affect performance or safety; a manufacturer of medical equipment or pharmaceuticals switched production from one country to another without changing the product or the production process; and an importer changed business locations within Japan. For starters, MHW clarified the scope and types of modifications to medical devices that do not require product reapproval. Moreover, the ministry said that effective July 31 a company changing its production location would only have to notify MHW of this move and provide certain supporting evidence. As a final step MHW streamlined product reapproval procedures for importers that change locations in Japan.

The United States was only partly successful in its parallel campaign to cut the red tape when foreign pharmaceutical or medical equipment makers wanted to transfer manufacturing approvals from Japanese companies or joint ventures in Japan to wholly owned Japanese subsidiaries. American negotiators argued that companies should not have to go through the approval process again if the product manufactured and the production process were unchanged; the transfer, they maintained, should be automatic. Tokyo agreed with this line of reasoning — but only up to a point. It decided that no new data would be required for the transfer of manufacturing approvals as long as the Japanese licensee was amenable to the change, but the ministry failed to come up with a simplified procedure for "unfriendly" transfers.

Rounding out the list of topics on Washington's initial agenda was a request for faster entry into Japan for imported medical equipment and pharmaceuticals. Tokyo's response was the adoption of a "one-stop" customs clearance procedure effective August 1. The new system meant that if a copy of a MHW approval certificate accompanied the imported product, Customs agents could pass it without waiting for MHW approval.

Even with mixed results on some items, the United States still achieved 90 percent-plus of its original objectives for the MOSS negotiations on medical equipment and pharmaceuticals. The issues pending at year-end were ones Washington had raised in the fall, including clarification of the approval process for procedure kits, the establishment of health insurance reimbursement rates for a newly registered medical device or diagnostic at the same time it is approved for sale, and a review of regulatory procedures for imported blood and biologicals to insure that they are based on reasonable scientific criteria.

Forest Products From the start Reagan administration trade policymakers knew that the negotiations on improved market opportunities for U.S. exporters of wood and paper products would be the most politically sensitive, in part because the Japanese forest products industry operated with a competitive handicap but also because domestic demand for most types of wood and paper products was slow-growing at best. The talks lived up to their advance billing.

Washington's initial call for deep cuts in what it had long considered Japan's prohibitively high tariffs on wood and paper products and its parallel but secondary demand for sweeping changes in standards, testing and certification procedures were rejected outright by Tokyo. Aware, though, that a stalemate in the forest products talks could jeopardize the whole MOSS process, Japanese negotiators bent a little in April on the top U.S. priority, saying that the government would "positively consider" tariff reductions on plywood and other panel products, possibly in 1987, as part of a five-year program to boost Japanese demand for wood products and improve the competitiveness of the domestic industry. This offer was dismissed as meaningless by American representatives, who continued to press their Japanese counterparts at every turn for substantive action.

As part of the July market access program, Tokyo finally said it would cut duties on panel products starting in 1987, but what the Nakasone administration billed as a major concession was rebuffed by Washington since Tokyo was unwilling to specify the products covered by this proposal and the depth of the planned reductions. The government's accompanying pledge to lower the tariffs on all paper products by 20 percent in April 1986 went over slightly better even though it fell short of American demands.

Although slow work, the two negotiating teams did manage to make some progress on technical issues during the summer and fall. For example, Japan said it would translate the national building code into English and work with American representatives to identify unnecessary restrictions on the use of wood products. One such barrier was eliminated when the requirements for 2x4 construction were changed to permit expanded use of 4x8 panels. Tokyo also agreed to appoint representatives of foreign companies as expert members of the technical groups responsible for establishing Japanese Agricultural Standards. In a related move government officials promised to allow foreigners to participate in the standards-drafting process, starting with the development of standards for structural panel products and laminated lumber. In addition, the two sides inched forward on Washington's demand that U.S. testing organizations be permitted to certify that American exports met Japanese lumber and plywood standards.

The progress on technical barriers to trade, though, was overshadowed by continued sparring over the planned tariff cuts on panel products. Throughout the fall American negotiators kept pressing their Japanese counterparts for more specific information on the duty reductions, but the response was always the same: the blanks could not be filled in until the details of the rehabilitation program for the forest products industry were finalized. Resolution of the tariff question, it was obvious, would require a political decision by Tokyo.

MOSS Wrap-Up Foreign Minister Shintaro Abe, who shared oversight responsibility for the MOSS talks with Secretary of State George Shultz, said in early December that Tokyo was prepared to conclude the negotiations by the December 31 target date set in late September. But whether the two sides met this schedule depended more on Washington than Tokyo. Since U.S. trade policymakers opted for a sectoral negotiating approach to the Japanese market access problems of American exporters and determined the agenda for each set of talks, it was up to them to decide whether sufficient progress had been achieved to declare the discussions a success.

Given the long list of results in the talks on telecommunications equipment and services, electronics and medical equipment and pharmaceuticals, the Reagan administration could justifiably declare the sectoral negotiations a success. But this verdict remained in question pending an eleventh-hour breakthrough in the forest products talks.

Tokyo was painfully aware of the fact that Washington's final assessment hinged on what it did about tariff cuts on panel products. During December the government struggled to work out a package of concessions that would be acceptable to the White House while triggering a limited

backlash at home. Officials thought they had come up with a workable solution, but when trade negotiators for the two countries met in Washington in early January 1986, the Japanese delegation quickly realized that they had not yet found the right middle ground.

The continued deadlock on tariff reductions put both Washington and Tokyo in an awkward position since Secretary of State Shultz and Foreign Minister Abe were scheduled to issue a joint statement on the MOSS talks on January 10. As late as January 8 the Reagan administration was prepared to declare a limited victory as long as the joint statement reflected the deep divisions over forest products. Policymakers knew that a split decision would lead to charges on Capitol Hill that the White House's new strategy for dealing with Japan had failed, but they were willing to take this risk. At the last minute, though, Tokyo came to the administration's rescue by making a fresh offer.

This offer, delivered personally by Mr. Abe on the evening of January 9, called for cuts ranging from 12.5 percent to 16.7 percent in the tariffs on plywood effective April 1987, followed by additional reductions a year later, plus lower duties on veneer and finished lumber. Tokyo also said it would immediately trim the duties on transom, other builders' carpentry and joinery, and fiber building board by 20 percent and move up the 20 percent tariff reductions on paper products from April 1986 to January.

While Tokyo's plan fell far short of U.S. objectives, particularly on the depth and timing of the tariff cuts on plywood, the White House, in an unexpected show of flexibility, decided it could live with the proposal. The two governments were therefore able to agree in their January 10 statement that the year-long MOSS process had yielded "important progress." "A great deal has been accomplished" in dismantling barriers to American products, Mr. Shultz reportedly told his Japanese counterpart in a private meeting, citing "very substantial purchases" as backing for this conclusion. Administration trade negotiators were less restrained in their off-the-record assessments, even admitting that the talks had succeeded beyond expectations in expanding access to Japan's telecommunications and medical equipment/pharmaceutical markets.

Some give-and-take was reportedly needed as well for agreement on the status report accompanying the Shultz-Abe statement. U.S. officials pushed hard for a candid account of the outcome of the four sectoral talks, arguing that anything less would not sell in Washington. Japanese negotiators were understandably reluctant to publicize the few shortfalls in the talks, but in the end accepted Washington's position. As a result, the joint report outlined not only the achievements of the negotiations but also the issues left on the bargaining table and the steps Tokyo still had to implement.

Despite the Reagan administration's favorable assessment of the MOSS talks, it was clear that Japan was not off the hook. Secretary of State Shultz underscored this point in his discussions with Foreign Minister Abe, saying that Washington's sectoral negotiating approach to the market access problems of American exporters would be extended in 1986 to other products. Regardless of the products selected, the second round of MOSS negotiations was expected to be as tough as the 1985 one — but equally productive.

NTT Procurement Pact

The first issue trade negotiators for the United States and Japan had to tackle in 1984 was extension of the 1981 bilateral agreement that opened Nippon Telegraph and Telephone's procurement process to foreign competition. Although the pact had not generated anywhere near the volume of business for American telecommunications equipment makers that American government and industry officials had anticipated, it was generally assumed that the Reagan administration would agree to a multiyear renewal of the accord beyond its December 31, 1983 expiration date. Industry watchers and Japanese government representatives alike were therefore caught off-guard by the White House's mid-December decision to ask Tokyo to extend the agreement for 90 days. Spokesmen said the two governments needed the short-term extension to work out the final details of a new procurement accord, but many observers on both sides of the Pacific worried that Washington and Tokyo were headed for a showdown over another trade issue.

This concern proved unfounded, largely because the U.S. government decided not to make renewal of the NTT agreement contingent on changes in Japan's satellite purchasing policies. During a series of meetings in the latter part of January, American and Japanese negotiators quickly wrapped up the loose ends of a revised, three-year accord designed to help U.S. manufacturers increase their sales to NTT. On January 30 Foreign Minister Abe and U.S. Trade Representative Brock signed an agreement extending the NTT procurement pact through December 31, 1986.

Many of the modifications incorporated in the revised agreement altered NTT procurement procedures that American companies claimed kept them from submitting bids or winning contract awards. NTT agreed, for example, to use performance specifications rather than design criteria in its requests for bids or proposals and to replace national standards with international ones. The company also promised to bring its standard contract terms and conditions into conformity with common international practice. Addressing another U.S.-identified sales deterrent, the government-owned carrier said it would limit requests for

proprietary information to those needed for product evaluation, development or use.

The renewed pact also formalized a number of changes NTT adopted on its own in March 1983 in an effort to facilitate sales by U.S. companies. These included publishing key procurement documents in English, accepting bids in English at the NTT office in New York City, and giving American suppliers extra time to respond to requests for proposals and bid invitations.

From Washington's perspective, though, the key improvement was the section that provided American suppliers the same opportunities as their Japanese competitors for early involvement in the research and development programs that generate products designed specifically for NTT's use. This provision, it was felt, would give frustrated U.S. telecommunications equipment makers a better shot at selling big-ticket, state-of-the-art products to NTT.

Because of persistent complaints from U.S. companies about the slow pace of NTT's purchases during the first three years its procurement was open to foreign competition, the Reagan administration insisted that the revised agreement contain an annual review provision. Should the United States become dissatisfied with the operation of the pact, it could ask for consultations. If these discussions failed to produce a satisfactory solution, Washington had the option to cancel the accord within six months.

U.S. government and industry complaints about the procurement agreement took a backseat in late 1984 to worries that the soon-to-be-reorganized NTT would no longer feel bound by the pact's terms. Doubts on this score, however, were put to rest in late January 1985 when Tokyo agreed that NTT would adhere to the purchasing agreement through 1986.

Beef and Citrus

At the beginning of 1984 Washington and Tokyo faced a familiar problem: coming to terms on a new arrangement expanding Japan's beef and citrus import quotas to replace the December 1978 accord due to expire at the end of March. Although talks had been underway since October 1982, the two sides were still far apart. The initial round of negotiations collapsed after the United States demanded that Japan decontrol imports of beef, oranges and orange and grapefruit juice on April 1, 1984. The Reagan administration took another stab at the issue in September 1983, suggesting phased-in liberalization through annual quota increases and calling on Tokyo to lay out a realistic timetable for removing the import limits.

This proposal was no more politically palatable to the Japanese government than the earlier demand. As Ministry of Agriculture, Forestry and Fisheries officials pointed out, the numbers outlined by the U.S. side — a 60 percent annual hike in the quota on high-quality beef, which stood at 30,800 metric tons in FY 1983, and a yearly 30 percent expansion in FY 1983's 82,000-metric-ton limit on oranges — would produce de facto liberalization within a short span of time. Moreover, these same officials said, the five-year deadline the United States had in mind for complete decontrol was out of the question.

The first glimmerings of a possible breakthrough in the talks appeared in October 1983. American trade representatives scaled back their target for annual quota increases to 45 percent for high-quality beef and 25 percent for oranges, although they apparently did not yield on the subject of a five-year timetable for liberalization. More importantly, the Japanese negotiating team finally tabled a counterproposal, reportedly offering to expand the high-quality beef quota by 3,000 metric tons a year to 42,800 metric tons in FY 1987 and to up the annual ceiling on orange imports by 7,000 metric tons over the coming four years to 110,000 metric tons. While this proposal was rejected out of hand by the United States, it did offer a starting point for negotiation.

Both sides took advantage of the lull presented by the December 1983 Japanese elections to work out new proposals and positions. These were unveiled in late January when Deputy USTR Smith met in Tokyo with Hiroya Sano, director general of MAFF's economic affairs bureau and Japan's chief agricultural negotiator. Although both sides were tight-lipped about the details of their discussions, informed sources in Tokyo reported that Japan offered to raise the quota on high-quality beef by 4,200 metric tons annually to 47,600 metric tons in FY 1987. On oranges, it was said, Mr. Sano offered to expand the FY 1984 ceiling by 11,500 metric tons and then to raise the limit by 8,500 metric tons in each of the following three years. The Japanese proposal apparently also included a four-year increase of 1,400 metric tons in FY 1983's 6,500-metric-ton cap on orange juice imports.

Countering this package of offers, Mr. Smith asked Japan to enlarge the quota on high-quality beef by 10,000 metric tons a year to 70,800 metric tons by the end of FY 1987. Moreover, he renewed an earlier U.S. call for an annual 10,000 metric-ton increase in the overall beef quota, which was set at 141,000 metric tons in FY 1983, so that Japan would not just shift its beef purchases from Australia to the United States to meet a commitment for greater imports of grain-fed beef. It was also reported that the U.S. negotiator proposed annual hikes of 15,000 metric tons for the orange quota to bring FY 1987 imports up to 142,000 metric tons. He apparently suggested as well that orange juice imports be expanded to 9,500 metric tons by the end of March 1988 through yearly rises of 1,000 metric tons.

While acknowledging that the gap between the two governments was wide, many observers on both sides of the Pacific thought that an eleventh-hour compromise was possible. This assessment proved overly optimistic. Despite a last-ditch round of working-level discussions, the March 31 deadline for a new agreement passed with Washington and Tokyo still deadlocked. It was not even clear whether the two sides yielded ground in the late March talks. The Japanese press reported that the United States had scaled back its quota proposals to 7,500 metric tons a year on beef and annual increases of 11,000 metric tons for oranges, while Tokyo had upped its offer on beef to 5,500 metric tons and stuck to the January bid on oranges. Deputy USTR Smith, however, took strong exception to these reports. Without giving any specific numbers, he maintained that Washington was holding out for bigger hikes in the beef and orange quotas than the figures indicated by the press. Left unsaid by Mr. Smith was that the Reagan administration expected significant increases in Japan's quantitative restrictions since the United States had formally shelved its longstanding demand for an import liberalization timetable.

Comments made by Japan's chief agricultural negotiator after the March talks also suggested that the gap between Tokyo's offer and the U.S. position was wide — too wide to bridge by simply splitting the difference. The reluctance of Agriculture, Forestry and Fisheries Minister Shinjiro Yamamura to travel to the United States for high-level negotiations without some signal of new flexibility from the Reagan administration indicated as well that the two were still far apart. Nevertheless, Prime Minister Nakasone, after conferring with top government and LDP officials, decided to send Mr. Yamamura to Washington to try and break the deadlock.

Three days of negotiations between Mr. Yamamura and USTR Brock during the first week of April ended in yet another impasse, although both sides were said to have moved slightly closer together on an increase in the beef quota, the most divisive problem. The MAFF minister was on the verge of flying back to Tokyo, but decided to return to the bargaining table on April 7, apparently at the insistence of the prime minister. To everyone's surprise, the two negotiators bridged their differences in fairly short order, agreeing on significant increases in Japan's beef, orange and citrus juice quotas over the next four years.

The agreement included the following points, according to the White House:

- Beef - Japan agreed to increase purchases of high-quality beef (defined as USDA "choice" and "prime" grades for beef bought from the United States) by 6,900 metric tons a year to 58,400 metric tons in FY 1987. Under the expired pact, imports had expanded from 16,800 metric tons in FY 1978 to 20,800 metric tons in FY 1980 and then to 30,800 metric tons in fiscal 1983. Most high-quality beef would continue to enter Japan under the general beef quota, which was set at 125,200 metric tons in FY 1983, with the rest charged to the hotel quota, one of four special beef quotas that totaled 15,800 metric tons in fiscal 1983.

- Oranges - The import limit on oranges, which was boosted from 45,000 metric tons in FY 1978 to 68,000 metric tons in FY 1980 and then increased by smaller annual increments to 82,000 metric tons in fiscal 1983, was to be raised by 11,000 metric tons a year for the next four years. These increases would lift the quota to 126,000 metric tons in fiscal 1987. The government was expected to continue dividing the quota into a general quota, applicable to the September-May period, and a seasonal quota for the months of June through May, the off-season for Japanese Mikan oranges.

- Orange juice - The quota on orange juice, fixed at 6,500 metric tons in fiscal 1983, was to be enlarged by 500 metric tons a year, bringing FY 1987 imports to 8,500 metric tons. This was the same rate at which the ceiling had increased in the post-FY 1978 period.

- Grapefruit juice - Limited to 6,000 metric tons in FY 1983, grapefruit juice imports were to be decontrolled retroactive to April 1, 1984. Import licenses would be required for the next two years, but the Japanese government pledged to grant any request for a license for any amount of purchase.

Top Reagan administration officials, who had adopted a no-holds-barred approach to venting their frustration over Japan's perceived intransigence on beef and citrus as well as other trade issues, expressed relief that a a major, though symbolic, irritant in the bilateral relationship had been eliminated. Domestic interest groups, if commenting at all, were generally cool toward the agreement. A spokesman for the National Cattlemen's Association, for example, indicated that his group was disappointed with the size of the increase in the beef quota — even though Japan is the dominant foreign buyer of U.S. beef.

Even with an agreement in hand, the beef and citrus dispute did not end because of the way Tokyo described two parts of the pact in its late April market access package (see Part III). It was Washington's understanding that imports of high-quality beef would expand by 6,900 metric tons a year, but Japan said that purchases would go up by 27,600 metric tons over the four-year period. While the end result was the same, administration officials were concerned that quota allocations would be bunched together to minimize the impact on the domestic market. They therefore sought Japan's pledge to adhere to a schedule of equal annual increases.

More disturbing to the U.S. government was Japan's presentation of its concession on grapefruit juice. In Washington's view Tokyo had agreed to grant any request for an import license for any amount of purchase in FY 1984 and FY 1985, after which imports would be completely decontrolled. The Japanese government, however, said it would set quotas for FY 1984 and FY 1985 on the basis of "actual" domestic demand. The Reagan administration had also expected Japan to lower the stiff tariff on fresh grapefruit in exchange for a two-year delay in the liberalization of grapefruit juice, but this cut was not included on the list of duty reductions announced in the market access package. Although it took until mid-August, Tokyo accepted Washington's interpretation of both its beef and grapefruit juice concession.

Other Agricultural Issues

The beef and citrus settlement set the stage for a truce on other agricultural trade issues. In late April the United States agreed to put a temporary hold on the complaint it had filed with the General Agreement on Tariffs and Trade in July 1983 on 13 of Japan's 22 agricultural quotas in exchange for Japanese trade concessions on some of these products. The compromise committed Japan to free imports of six items during FY 1984, including canned pork products and hi-test molasses, and to raise the quantitative limits on nine products, such as tomato juice, ketchup, tomato sauce and canned pineapple. For its part, the United States agreed to a two-year suspension of its plan to have a GATT multinational panel arbitrate the dispute over farm quotas — a step Washington was prepared to take after four rounds of Article 23 consultations had yielded little change in the Japanese position.

At first glance Japan's concessions, which were part of its latest market access package, did not appear to be very meaningful. U.S. trade negotiators would be the first to admit that the proposed changes did not measure up to expectations, but they maintained that the bilateral pact did provide some new trade opportunities for individual exporters. For example, manufacturers of cake mixes, breakfast cereals, granola bars and similar processed products containing sugar were expected to benefit from a change in the coverage of this quota category. Previously it limited imports of a variety of products that have sugar as the main ingredient by weight; in the future the restrictions would apply only to food preparations containing 50 percent or more sugar by weight. Liberalization of prune and cranberry juice and larger quotas for apple and grape juice were also expected to generate added sales for U.S. companies. So, too, would the decontrol of fruit purees, paste and pulp other than peach, apple, grape and pineapple and bigger quotas for the products still subject to restriction.

Translating some of Japan's other concessions into sales was expected to be more difficult. One of the items on the liberalization list, for instance, was canned pork products, but U.S. efforts to exploit this market could be stymied by a new variable tariff on imports. Likewise, bigger quotas for tomato juice and ketchup and tomato sauce might not make much difference for American exporters without changes in import licensing requirements; however, Japan's willingness to lower duties on all three products could eliminate one cause of limited U.S. sales. In a similar vein, the proposed cut in the tariff on peanut butter could prove more useful to domestic firms than the new minimum quota for peanuts since this allocation was only slightly higher than recent allotments. Moreover, some of Japan's concessions required clarification before their trade impact could be evaluated.

The truce on agricultural trade issues began to unravel at the end of 1985. At a working-level session held in early December, Reagan administration officials renewed their call for the complete liberalization of the 12 quota categories made up of processed agricultural commodities and food products, or at least a firm timetable for decontrol. (The other category included in the GATT complaint — provisionally preserved oranges and tangerines — was subsequently folded into the beef and citrus agreement.) The Japanese delegation rebuffed this demand, offering, as it had in the past, to expand quota volumes and cut tariffs.

While neither side expected the politically charged quota issue to be resolved in one meeting, both Washington and Tokyo had hoped that the break in negotiations would produce changes in the other government's position. The fact that the two negotiating teams picked up where they had stopped 19 months before signaled tough going ahead.

Tobacco Products

Another long-simmering dispute flared up in early April 1984 when the Nakasone cabinet approved a legislative draft that would transform Japan Tobacco and Salt into a semi-private corporation effective April 1, 1985 (see Part III). Hand in hand with this reform, the tobacco products import and distribution businesses would be opened to foreign companies and domestic firms alike. Once they registered with the Finance Ministry, new distributors would be able to sell directly to Japanese retailers. In addition, MOF would no longer have to license retail outlets before they could carry foreign cigarettes and other tobacco products.

What most interested American manufacturers, though, were the proposed changes in the pricing system for foreign cigarettes since they had long argued that the government-determined formula discriminated against imported brands. This formula was to be altered in two ways. The tobacco excise tax would remain equal to 56.5 percent of the retail price; however, it would be calculated from a fixed per-cigarette charge equivalent to about 20 percent of the retail price, plus an ad valorem tax that would bring the effective

rate up to the 56.5 percent level. Japanese officials felt that this computational modification would favor higher priced products such as imported cigarettes. Moreover, foreign cigarette producers would be allowed to determine their own prices as long as they took into account national and local taxes and the tariff; Finance Ministry approval of these prices would be "essentially" automatic.

U.S. cigarette manufacturers were either cautiously silent or outright cynical about the package of measures. Most claimed that the proposed legislation would have no effect on foreign sales because it did not eliminate the heart of the problem — the discriminatory pricing system for foreign cigarettes. Looking at their meager 2 percent-plus share of Japan's $10 billion market, corporate spokesmen said that even if the price differential between foreign brands and domestic ones shrank from 40 percent to 25 percent as envisioned in the draft legislation, JTS's successor corporation would still have a stranglehold on the market and would find ways to discourage foreign penetration.

The Reagan administration's response was decidedly more upbeat. In a May 1 statement USTR Brock called the proposed reforms a "significant market opening for U.S. producers," adding that they could mean billions of dollars in sales. He said the Japanese government had reassured him that price approval and import-distribution registration "will be neither burdensome nor discriminatory." Nevertheless, Mr. Brock indicated that American officials would remain in close contact with their Japanese counterparts to insure that the reforms did result in real market opportunities for U.S. cigarette makers.

The response from these companies remained mixed. R.J. Reynolds Tobacco International Inc. had at first expressed some disappointment over the package's limited scope, with a spokesman commenting that the "creation of a private company would have given importers more flexibility." In a statement released immediately after Mr. Brock's, however, R.J. Reynolds said it welcomed the proposed modifications: they "allowed greater latitude in importing, distributing and selling" tobacco products in Japan. The firm noted, though, that "there is room for improvement in certain sectors." Philip Morris Inc., which accounts for around 80 percent of all sales of imported cigarettes in Japan, said it welcomed any liberalization but continued to argue that the discriminatory pricing system must be overhauled. The company added that much needed to be done to insure that reality matched the government's rhetoric.

Despite the mixed reaction of U.S. cigarette exporters, the reform proposals, which were passed by the Diet in the summer of 1984, brought a temporary end to the trans-Pacific bickering over the market access problems of U.S. cigarette makers in Japan. But this lull came to an abrupt end five months after the reforms were implemented. One of the three cases the White House decided to self-initiate under Section 301 of the 1974 Trade Act as part of its September 1985 effort to derail protectionist legislation in Congress covered Japan's cigarette policies (see Part II).

Changes in Tokyo's pricing policies for imported cigarettes and its eased limits on marketing, advertising and distribution notwithstanding, the Reagan administration maintained that U.S. cigarette exporters were still handicapped in competing with the renamed Japan Tobacco Inc., the country's only authorized manufacturer. Their biggest disadvantage, said American suppliers, was the fact that Japan's tobacco excise tax was calculated on the landed price of imported cigarettes including the 20 percent tariff. This "tax on a tax," it was argued, opened up a significant price differential between foreign and Japanese cigarettes that cost roughly the same amount to produce. It therefore kept the U.S. share of Japan's huge cigarette market at only 2 percent-plus despite the pricing and other changes introduced in April.

The heart of the 301 complaint drawn up by the Office of the U.S. Trade Representative was that Japan "continues to impose relatively high tariffs, to prohibit foreign firms from manufacturing tobacco products in Japan and to restrict the distribution of tobacco products." Building on this theme, supporting briefs filed by the United States Cigarette Export Association and the Liggett Group Inc. argued that Japan continued to employ a host of tariff and nontariff barriers to restrain the growth of foreign firms' market share.

Lawyers for JTI took strong exception to these charges, maintaining in a mid-September brief that they did not reflect current conditions. Addressing the allegations one by one, JTI pointed out that:

- Japan's tariff on cigarettes was reduced from 90 percent to 35 percent in April 1981 and then to 20 percent ad valorem equivalent in April 1983, a level at or below that of the United States. (The duty was 10 percent ad valorem plus ¥342 per 1,000 pieces, which was approximately equivalent to a pure 20 percent ad valorem rate.) Furthermore, the tariff was nondiscriminatory and wholly consistent with Japan's obligations under the GATT.

- The computation of Japan's excise tax on tobacco products was changed from wholly ad valorem to a combination fixed rate/ad valorem method in April 1985. Although the excise tax was still computed on the basis of after-tariff prices, the overall effect was similar to the treatment of foreign cigarettes in the United States.

- All restrictions on access to retail outlets had been eliminated. As of March 1985 the number of retail outlets

allowed to carry foreign cigarettes stood at 117,000, up significantly over the year-earlier level of 70,000.

- Cigarette companies could set their own retail prices subject to minimal government criteria. The Ministry of Finance must approve a foreign manufacturer's retail price request unless it would injure consumer interests or is determined to constitute predatory pricing. As additional evidence, JTI claimed that prices on some existing U.S. brands had already fallen to levels comparable to those of domestic brands and that a new brand introduced by Philip Morris was priced exactly the same as a popular domestic brand.

- Tobacco product manufacturers were free to establish retailer margins since the mandatory 8.5 percent margin set in April 1981 had been abolished in April 1985.

- Foreign tobacco firms could set up their own distribution network, use JTI's existing network or use a combination of the two. American companies had in fact pursued the last alternative, according to JTI. Major foreign manufacturers had tied up with Japanese trading companies to establish new distribution channels, while immediately availing themselves of JTI's established network.

- All advertising rules applied equally to foreign and domestic brands. The advertising code was made voluntary in April 1981, and limitations on advertising budgets were revised after April 1985. Under the existing code television and radio exposure as well as advertising in print media were limited on a per-brand basis instead of a per-company basis.

- Test marketing requirements had been abolished. Under January 1980 provisions a new brand had to be test marketed for one to two years at a limited number of retail outlets; only if the sales volume attained a specific level was national marketing permitted. The test period was reduced to six months and the minimum sales level lowered in April 1981.

Japan did not dispute the fact that JTI retained its monopoly over the production of cigarettes, cigars and pipe tobacco, but argued that this was permitted under the 1953 U.S.-Japan Treaty of Friendship, Commerce and Navigation. The key provision of the treaty grants each party only the right to national treatment with regard to the establishment of enterprises, JTI's lawyers pointed out, not the absolute right of establishment. Because the law creating JTI stipulated only that it was the sole manufacturer of tobacco products in Japan and barred both foreign and local companies from domestic production, the brief continued, it fulfilled the required equal national treatment clause. Furthermore, another article of the treaty acknowledges the government's right to grant exclusive privileges to government-owned or government-controlled enterprises.

This long list of rebuttals boiled down to one simple point: the practices enumerated in the USTR complaint were no longer employed or they were permitted under existing treaties. But as part of President Reagan's "get tough" trade policy, the White House apparently felt that Japan had to be the target of at least one new investigation. The size of Japan's cigarette market and the competitiveness of U.S. manufacturers made tobacco products an obvious choice. Resolution of this case would have to wait until 1986.

Leather and Leather Products

Another long-running bilateral trade dispute — this one over Japan's import quotas on leather and leather footwear — was also targeted by the White House as part of its September 1985 campaign to demonstrate to Congress that the administration was prepared to crack down on unfair foreign trade practices. Here, though, President Reagan announced that the United States was prepared to retaliate if a 301 complaint that dated back to 1977 was not cleared up by December 1.

In mid-March 1984 a GATT arbitration panel concluded that Japan's quantitative restrictions on leather imports were inconsistent with international trade rules. Although Tokyo accepted this finding, it had yet to take any meaningful corrective steps, the Reagan administration asserted, adding that Japan's offer to replace the quotas with higher tariffs was unacceptable because this move would do nothing to lift the U.S. share of the $1.6 billion leather market beyond the existing 1 percent level.

The leather footwear issue was more complicated. The GATT had not yet ruled on whether Japan's quotas on leather footwear violated its international trade obligations when Mr. Reagan issued his ultimatum. In fact, in July 1985 the organization's decisionmaking council rebuffed a U.S. request that the findings of the panel that had examined Japan's leather quotas be applied to its quantitative limits on leather footwear. Convinced, however, that the GATT would arrive at the same conclusions on footwear as it did on leather, Washington demanded immediate action from Tokyo to improve American access to its $2.7 billion leather footwear market.

The White House's new get-tough trade policy quickly faced its first test as the December 1 deadline for action came and went without Tokyo presenting what the administration considered an acceptable alternative to the quotas on leather and leather footwear. Not even a one-day extension of the deadline helped break the impasse.

Washington's definition of an acceptable replacement for Japan's quotas was never made public. All that was certain was that Tokyo's repeated offer to replace its quantitative limits with tariff quotas did not meet U.S. criteria. Under this proposal, scheduled for implementation in April 1986, imports of leather and leather footwear would be dutiable at the existing rates of 20 percent and 27 percent, respectively, up to an unpublicized volume; above this amount, which would be increased annually for five years, tariffs would jump to 60 percent. American trade officials apparently rejected this offer out of hand, maintaining that the system outlined by Tokyo was no less restrictive than the present one. Japan's companion offer to compensate the United States and third-country suppliers by lowering tariffs on other products of interest to them did nothing to lessen U.S. resistance to the main proposal.

A personal plea to the president from Prime Minister Nakasone, delivered December 2, bought Tokyo some time. After apparently alluding to the political constraints limiting Tokyo's ability to liberalize trade in leather and leather footwear, the Japanese leader reportedly urged Mr. Reagan not to retaliate. He added that if the White House believed reprisal was necessary, the announcement should be delayed until the end of the Diet's special session, scheduled for December 21, to minimize the domestic political fallout. But the president was in a political bind of his own. Unless he took action soon, the White House's new trade policy might be interpreted on Capitol Hill as just rhetoric.

Following some pre-Christmas compromising by Japan and the United States alike on the terms of a settlement, Washington called a truce in the dispute. The agreement worked out December 21 allowed negotiators for both governments to claim that they achieved their minimum objectives. By gaining a trade package that would provide $236 million worth of compensation to American exporters plus withdraw $24 million worth of U.S. concessions on leather imports from Japan, the Reagan administration won dollar-for-dollar coverage for what it estimated Tokyo's trade restrictions on leather and leather footwear cost the United States. The Japanese government likewise attained its basic goal: continued protection for domestic manufacturers of leather and leather products, although starting April 1, 1986, this protection took the form of tariff quotas rather than straight import quotas.

According to a fact sheet prepared by the Office of the U.S. Trade Representative, the main elements of the trade package included:

- Additional market access in Japan for U.S. leather products;

- Reduction or elimination of Japanese tariffs on 137 products, including paper, glass, automotive equipment, film, telecommunications equipment and parts, scientific equipment and sporting goods effective April 1, 1986;

- Guarantees by Tokyo to make permanent previous tariff cuts on 242 other products;

- Reduction of Japanese duties on five aluminum products as well as a commitment by Tokyo to consult on other issues affecting bilateral trade in aluminum; and

- U.S. withdrawal of concessions on leather imported from Japan through the imposition of "significantly" higher duties. This action, observers noted, marked the first time Washington had retaliated against Tokyo under Section 301 of the 1974 Trade Act.

Legal Services

Japan's position as a major trading nation and financial power has generated a demand for nonlitigious legal services. With less than 13,000 lawyers, the country is unable to meet the needs of clients to structure or draft financial transactions that require specialized knowledge and foreign language skills. Developments in 1984 and 1985 moved this issue up on the agenda of both American and Japanese negotiators.

Japanese *bengoshi* — lawyers with competence in all areas of criminal and civil law who can represent clients in court — are an elite group. Of over 35,000 applicants in 1984, only 500 passed the national legal examination, or well under 2 percent. Certification as a *bengoshi* has been available to foreigners for a number of years, but the difficulties involved in earning the title have effectively barred foreign applicants. At the same time, demand for legal advice, particularly trade-related information, was growing — a demand only *bengoshi* could meet.

Since there was clearly a shortage of legal services, foreign governments had long urged Tokyo to allow foreign lawyers to practice in Japan. The question of liberalizing access to the legal profession in Japan was first raised by Washington in 1979. In 1982 the United States formally spelled out American concerns on the subject.

The U.S. government considered the issue a trade problem that, symbolically at least, reflected Japan's attitude toward an open market. USTR officials acknowledged that the value of legal services would be small, but argued that the impact of liberalization could be large in terms of facilitating trade in goods and services and the psychological environment. First, though, trade negotiators had to come to grips with the power and conservative bent of the legal profession in both countries. Internationally oriented U.S. practices pressured USTR to push the issue, while the Japan

Federation of Bar Associations (Nichibenren) proved its strength by resisting significant changes. The Justice Ministry was caught in the crossfire; it could not move without the backing of Nichibenren, but could not escape criticism if it failed to act.

To the Japanese bar association, the issue was a question of professional standards and economics. JFBA was unwilling to reduce its strict standards of conduct and quality just for foreign lawyers. Opening the profession to all foreign lawyers, it was thought, would present a threat to the legal profession's livelihood. Some Japanese lawyers, however, were willing to accept foreign trained practitioners, arguing that they would supplement, not supplant, the services offered by *bengoshi*.

Tokyo formalized its determination to pursue the issue in its late April 1984 trade liberalization package. The Ministry of Justice promised to submit legislation as soon as Nichibenren came up with a proposal, but the legal association had trouble reaching a consensus. In May JFBA tentatively agreed to create a "foreign legal consultant" category that would allow foreign lawyers to conduct activities in Japan under the supervision of the Japanese bar and in accordance with new legislation. This proposal was finalized in early December 1984, but the organization still had to overcome a wide split among its members.

The details of the final plan were essentially unchanged from those contained in an early November draft proposal that had received negative reviews from U.S. lawyers and businesses. Foreign observers criticized nearly every aspect of the draft plan, which would only allow foreign lawyers approved by Nichibenren to give advice on the laws of their home country. The sections that received the most fire were the strict approval requirements (five years legal experience in their home country), the narrow scope of permitted activities and the two- or three-year duration of approval. The president of the American Chamber of Commerce in Japan applauded Nichibenren's attempt to find a solution, but said the proposal was as restrictive as the existing situation. Foreign lawyers operating in Japan (as trainees in association with a Japanese law firm) were also unhappy with the draft, calling it a counter-liberalization proposal.

The final proposal retained these controversial points but compounded the problem by totally banning associations between foreign and Japanese practices and creating reciprocity conditions. Foreign lawyers would be barred from forming international law firms with Japanese lawyers, from hiring Japanese lawyers and even from advising foreign clients in negotiations with Japanese parties. The reciprocity guidelines — which called for restricting the proposed limited access to lawyers from countries that granted Japanese barristers similar access — became the subject of heated debate within the federation and between Washington and Tokyo. (At that time only members of the Massachusetts, New York and Washington, D.C. bar associations would have satisfied this condition.)

USTR responded to the federation's proposal with its own list of suggestions at the beginning of May 1985. These included:

- Reciprocity — USTR officials consistently opposed any reciprocity provisions because the two bar systems are so different. Japan has a federal system, while the United States employs a confederative one. Tokyo should follow a case-by-case approach applying a "real cause" criterion, Washington maintained. The regulatory authority should "consider whether in the jurisdiction in which the foreign lawyer is licensed to practice, a Japanese lawyer (*bengoshi*) would have a reasonable and practical opportunity to give legal advice on the law of any other jurisdiction than the law of the United States." The possibility that a Japanese lawyer might encounter problems was not a sufficient reason for denying reciprocity to a foreign lawyer, USTR added; the only real cause would be a complaint from a Japanese *bengoshi* who was actually applying to practice in that foreign jurisdiction.

- Qualifications — The United States wanted a much simpler standard than Nichibenren. In the U.S. view an applicant should simply be of good character and professional standing in his jurisdiction and have a minimum of one year of consulting experience.

- Offices and scope of business — Other than agreeing that a foreign legal consultant's advice should be limited to non-Japanese law, USTR's proposal contained no restrictions whatsoever.

- Regulatory authority and duration of registration — Washington argued that since foreign legal consultants would not be admitted to Japanese bar associations, they "should be regulated by the Ministry of Justice or other appropriate agencies, and not the Nichibenren." For the same reason, the "regulatory authority [should] not require any test or evaluation, including, but not limited to, testing of the foreign lawyer's understanding of the Japanese language, society, culture or basic legal system." Although the regulators could set "reasonable standards of professional ethics and integrity and disciplinary rules and procedures to be enforced by the authority itself," USTR went on, the duration of the registration should "continue unless surrendered or revoked for good cause after an open hearing by the appropriate regulatory authority."

USTR officials felt that the Japanese government was taking a pragmatic approach to the problem and would eventually prevail on Nichibenren to approve a more liberal system. Despite this judgment, no timetable was

mentioned, suggesting that the issue had a low priority. Meanwhile, Nichibenren continued to work on a compromise proposal to give foreign lawyers more freedom to advise Japanese clients on non-Japanese law. The Justice Ministry had hoped to be able to draw up amendments to the Attorneys-at-Law Act in time for submission to the regular Diet session starting in December 1985. But the JFBA proposal remained unpalatable to Washington, and Tokyo held off submitting any legislation while the two sides talked.

Access to U.S. Markets

In many ways, the problems Japanese exporters faced in marketing their products in the United States in the mid-1980s were mirror images of those American exporters had to deal with in Japan. There was one key difference, though. Rather than obtaining access, Japanese suppliers were fighting to maintain access. Moreover, Japanese companies were criticized for being too successful at competing with domestic manufacturers rather than for not trying hard enough. In some cases, the twin access issues became intertwined. For example, U.S. semiconductor makers argued that Japan's closed market helped Japanese competitors mount aggressive drives to penetrate the U.S. market.

The disputes with Japan continually tested the Reagan administration's commitment to free trade. Indeed, the cabinet was deeply split on virtually every issue concerning Japan's continued access to the American market. Tokyo's cohesion and flexibility were also exposed to new pressures. More importantly, its policies were held to new standards. Liberalization, deregulation and internationalization had become buzz words in Japan's efforts to adjust its policies and priorities to its economic strength, and foreign expectations were heightened because of this.

Semiconductors

Unlike previous U.S. economic rebounds, the recovery and expansion of the mid-1980s did not put a damper on complaints from American manufacturers about import competition. There was no mystery why. For starters, the 1984 turnaround completely bypassed some major industries; in others, demand was not as robust as the strong showing of business investment and consumer spending would have indicated. But even those industries that benefited the most from the economy's vigorous performance shared one problem in common with those left behind: foreign suppliers, aided by the overvalued dollar, siphoned off a bigger share of U.S. business. To make matters worse, the expansion lost a lot of its steam in 1985, yet imports continued to make inroads into the American market.

The long list of industries lobbying the executive branch and Congress for protection from imports, whether from Japan or elsewhere, was headed by such familiar names as steel, textiles, cars and machine tools. There was general agreement in Washington, though, that the mounting competitive problems of U.S. semiconductor makers — which industry representatives blamed squarely on pervasive unfair trade practices by Japanese manufacturers in this country and at home — represented the key trade issue in the bilateral relationship. Unless these problems were addressed quickly, government and industry officials maintained, the United States risked losing world leadership in a technology considered to be the building block not just for sophisticated electronics but for a whole host of other products as well.

The semiconductor issue came to the fore in the spring of 1985 as hard times again rocked the cyclical U.S. industry. Orders had been on the skids since the previous summer when computer makers began cutting back new bookings and canceling existing ones. With no signs of a turnaround in sight, semiconductor houses laid off thousands of workers, instituted shorter work weeks for remaining employees, mothballed wafer fabrication facilities, and halted new building programs in an attempt to protect earnings. But these efforts were only partly successful since profits were also being squeezed by rampant price cutting in memory chips and weakening prices for other devices.

The slump gripping U.S. semiconductor manufacturers gave new life to the industry's dormant campaign for legal action against Japanese semiconductor suppliers. During the 1980-81 semiconductor business bust, Motorola Inc. and some other leading merchant makers had lobbied hard for an industry-backed antidumping complaint charging Japanese exporters with "buy-in" pricing in the American market for 64K dynamic random access memories. That bid, rejected in March 1982 by the Semiconductor Industry Association's deeply divided board of directors, was quietly shelved when the American memory market took off in the spring of 1982.

It was replaced by a new campaign, also spearheaded by Motorola, to counter the alleged effects of Japanese government-industry targeting of the semiconductor business. This effort to win industry support for an unfair trade practices complaint under Section 301 of the 1974 Trade Act fizzled out in 1983 after SIA's board of directors split in February over the wisdom of going the trade-complaint route and then in July postponed consideration of legal action, citing the "favorable results" U.S. trade negotiators had achieved in bilateral discussions to improve American access to Japan's semiconductor market.

Interest in an unfair trade practices complaint against Japan revived in 1985 along with the deepening industry slump. A number of SIA member companies, however, still had strong reservations about filing a 301 petition. Moreover, semiconductor executives remained split on what action the Reagan administration should take if Japan did not eliminate its alleged unfair business practices. Industry sources reported that merchant manufacturers generally pressed for quotas on U.S. imports of Japanese-made integrated circuits — a position vigorously opposed by International Business Machines Corp. and other computer makers that belonged to SIA. At an early June meeting the association's board voted — after a debate described as heated — to file a 301 complaint but to drop quotas as a recommended option.

This decision raised an intriguing question: how did supporters of legal proceedings against Japanese makers finally win the backing of reluctant SIA member companies for an industry-initiated complaint? Rapidly deteriorating market conditions certainly provided powerful ammunition, but this was obviously not the first time American manufacturers of semiconductors for the merchant market had been caught in a slump that showed no signs of ending quickly. What apparently made the difference this time were the ambitious capital spending plans of Japanese semiconductor producers in a market already plagued with overcapacity.

Semiconductor makers in both the United States and Japan had gone on an investment spree during the 1983-84 boom. This new capacity started to come onstream just as demand began to weaken, putting enormous pressure on prices. With orders continuing to slump in this country, American companies cut their 1985 plant and equipment budgets. So did Japanese suppliers — but by a much smaller margin. For U.S. semiconductor producers and customers, this situation raised the specter of a crippling chain reaction. Japanese makers anxious to sell the output of their new factories would have little choice but to dump commodity products like DRAMs on the U.S. market. American companies would be forced to the sidelines, first in DRAMs and then in other product lines as the profits needed to finance ever-increasing research and development costs and capital spending requirements dried up. Increasingly, this scenario went, U.S. computer manufacturers and other big semiconductor users would become dependent on Japanese companies that were also their competitors in end-product markets for outside supplies of chips.

The unfair trade practices complaint SIA filed with the Office of the U.S. Trade Representative in mid-June sought White House intervention on two fronts: to stop allegedly predatory pricing by Japanese semiconductor makers in the United States and to help American semiconductor manufacturers crack the Japanese market, where, it was claimed, U.S. sales had never exceeded 10 or 11 percent of consumption for any sustained period because of an evolving set of barriers. SIA argued that the major obstacle to American suppliers attaining a position in Japan more in line with their international standing was the structure of the market itself. The biggest Japanese customers for semiconductors were also the leading producers of these devices, the trade association noted, adding that these vertically integrated firms had a collective interest in buying Japanese.

The SIA petition, which the Trade Representative's office accepted less than 30 days after filing, outlined three ways in which the president might exercise his broad authority under Section 301 to counter allegedly unjustifiable or discriminatory trade practices of other countries at home, in the United States or in third markets. Unless their access to the Japanese market improved quickly, U.S. semiconductor makers suggested that the Reagan administration start an unfair trade practices proceeding under the General Agreement on Tariffs and Trade. To stop what they claimed were the illegal pricing policies of their Japanese competitors in the U.S. market, American makers proposed two options for presidential consideration: a Justice Department investigation into whether Japanese suppliers had violated antitrust law by engaging in predatory pricing and a Commerce Department cost-price model of Japanese semiconductors that would trigger antidumping investigations if there were indications of U.S. sales of Japanese-made chips at less than fair value.

The 301 complaint proved to be just the opening salvo in the U.S. semiconductor industry's campaign for legal action against Japanese competitors. This drive got a shot in the arm in early August when it was revealed that Justice had opened an investigation into possible predatory pricing by Hitachi, Ltd. The antitrust inquiry was disclosed by Sen. Pete Wilson during a Joint Economic Committee hearing in Santa Clara, California on Japanese semiconductor trade practices. In early June the California Republican along with Sens. Frank Lautenberg (D, N.J.), John Danforth (R, Mo.) and David Boren (D, Okla.) had asked Justice to look into Hitachi's U.S. pricing policies, maintaining that "significant evidence exists" to prove that the number-two Japanese semiconductor maker violated antitrust law.

Providing the core of this "evidence" was the so-called "10 percent memo." This memo, circulated in late February by Hitachi America Ltd.'s San Jose, California office, urged the company's distributors to undercut the prices for 128K and 256K EPROMs (erasable, programmable read-only memories) quoted by Intel Corp. and Advanced Micro Devices Inc. as well as by Fujitsu, Ltd. by 10 percent, no matter how low the bidding got.

Hitachi executives had repeatedly repudiated the memo as the work of over-zealous U.S. employees; they emphasized

that the document, which was rescinded one week after being released, did not reflect the company's marketing strategy for EPROMs or any other devices. Spokesmen for Intel and AMD countered that whether or not the memo represented corporate policy was beside the point: their companies had had to contend with Hitachi pricing that was so aggressive it could only be designed to buy EPROM market share.

Allegations of predatory pricing were also at the heart of the dumping complaint Micron Technology Inc. filed in late June. The Boise, Idaho firm charged that Japan's seven biggest semiconductor suppliers were not only selling 64K DRAMs here at less than fair value but also marketing them at prices below the cost of production. In its petition Micron claimed that Japanese vendors successively lowered their prices on volume 64K DRAM orders from the $2.30-per-part level prevailing in October 1984 to between 70 and 75 cents — roughly half of their presumed production costs — in an attempt to drive American competitors out of the market for the workhorse memory. Once they captured the market, Micron continued, Japanese suppliers could easily raise prices and recover the money lost in their takeover bid.

Japanese semiconductor manufacturers found it ironic that Micron should be the company to file the first dumping complaint against them. After all, they pointed out, it was Micron that set off another round of price cutting in the fall of 1984 by unilaterally dropping prices on 64K memories below the $2 point. At the time U.S. industry trade journals quoted Micron's chairman as saying that the firm cut prices in part to meet commitments it had made to its principal customers about year-end prices. It was also speculated the Micron lowered prices in an effort to lock in customers for the large amount of new memory capacity it had coming onstream.

The other shoe dropped in late September when three leading U.S. makers of EPROMs filed a dumping petition against Japanese semiconductor producers. In their complaint Intel, AMD and National Semiconductor Corp. — the biggest American EPROM suppliers after Texas Instruments Inc. — charged that Hitachi and seven other Japanese manufacturers were selling all densities of EPROMs here for less than in Japan and also marketing them at prices well below their costs of production.

The price erosion of current-generation 256K EPROMs, the petition claimed, epitomized what had happened across the board when Japanese vendors entered the U.S. memory market. Prices of 256K EPROMs had followed a normal learning-curve slope through 1983 and 1984, averaging about $17 per unit at the start of 1985. At that point, though, Japanese companies began to sell the part in volume, and in the ensuing battle for orders in the contracting U.S. marketplace, prices skidded. By August, the three American makers asserted, quotes had dropped to the $4 level even though it cost Japanese makers an estimated $6.34 to produce the 256K device.

The EPROM dumping petition came as little surprise to U.S. semiconductor industry watchers. Until 1985 EPROMs had sheltered Intel, AMD and other makers of MOS memories from the cutthroat pricing in DRAMs, this market's major segment. Intel and AMD executives, however, had complained bitterly about aggressive Japanese EPROM pricing ever since Hitachi's "10 percent memo" had surfaced. The major question mark, trade sources reported, involved strategy. Some industry officials apparently felt that a dumping petition might limit the ability of the Reagan administration to negotiate additional U.S. access to Japan's semiconductor market using as its springboard the SIA's 301 complaint. The only other holdup was gaining the backing for legal action from as many producers of EPROMs as possible.

With the semiconductor trade issue placing increasing strain on the bilateral economic relationship, both Tokyo and Washington were anxious to work out the terms of a settlement, even going so far as to pencil in a year-end 1985 deadline for agreement on the framework of a plan. Following off-and-on discussions in the late summer and early fall, Ministry of International Trade and Industry officials outlined a two-part settlement plan to their counterparts from USTR and Commerce in November. Tokyo, it was proposed, would set floor prices under U.S.-bound shipments of DRAMs and EPROMs and encourage 11 major Japanese electronics companies to expand purchases of American-made circuits by one-fourth if, in return, SIA dropped its 301 petition and U.S. semiconductor makers pulled the dumping complaints they had lodged against Japanese-supplied 64K DRAMs and EPROMs. After consulting with industry representatives, the American negotiating team turned down this offer as an inadequate response to the trade problems of U.S. semiconductor makers.

What happened at that point is a matter of dispute. Administration officials claimed that Tokyo broke off the talks in early December without coming back with a revised proposal. The Japanese side replied that it was left with no choice after President Reagan, in a clear signal that his administration was prepared to do battle for the beleaguered U.S. semiconductor industry, gave Commerce the green light to start an antidumping investigation of current-generation 256K DRAMs imported from Japan.

This move marked the first time the U.S. government had self-initiated an antidumping or countervailing-duty case outside the framework of an established program like the steel trigger price mechanism. But it was another break with past U.S. trade practice that won applause from American manufacturers and sent tremors through the

Japanese industry. Any dumping duties levied on 256K memories would also be applied to higher-density DRAMs brought in from Japan, starting with the 1-megabit chip that some companies were already shipping in sample quantities. Said Alan Wolff, SIA's Washington counsel, "The fact that this case would have consequences for later generations shows that the government is now focusing on preventative steps rather than just [attempting] to remedy injuries. That's extremely significant."

In giving the go-ahead on the 256K DRAM proceeding, President Reagan endorsed the first recommendation of the special cabinet-level "strike force" set up to uncover and eliminate unfair foreign trading practices (see Part II). The proposal was reportedly sent to the White House in early November, just a month after the panel began work, but it was put on hold while Washington and Tokyo tried to reach a negotiated solution on the overall issue of allegedly unfair Japanese competition in semiconductors. Convinced by the first days of December that the discussions would not lead to an acceptable outcome, U.S. trade negotiators apparently urged President Reagan to sign off on the proposed action against Japanese-made 256K DRAMs.

The fact that the administration's trade strike force moved so quickly on the current-generation DRAM issue was a tribute to the lobbying efforts of leading merchant semiconductor makers. Unable to win the backing of their trade association for dumping proceedings against the "buy-in" pricing of Japanese vendors in the American market for commodity memory products, companies like Intel, National Semiconductor and AMD had been pressing the administration since at least mid-summer to carry the ball.

The hand of merchant manufacturers was also evident in the strike force's selective interpretation of the causes of the U.S. industry's troubles. Nowhere in its fact sheet was there mention of the year-long, across-the-board U.S. order slide. Responsibility for industry lay-offs, current and future corporate losses on 256K DRAMs and the withdrawal of several leading makers from all or certain segments of the market was placed solely at the doorstep of Japanese competitors, which supplied roughly three-fourths of the American 256K DRAM market in 1985's first nine months.

Similarly, Commerce Secretary and strike force chairman Malcolm Baldrige blamed a "surge in shipments" from Japan for the collapse of 256K DRAM prices. Prices had dropped from an average of $18 to $20 per part in 1984 to $2 in late 1985, he noted, implying in the process that this drop did not follow the normal learning-curve slope for chip prices. Mr. Baldrige added that there were indications that Japanese semiconductor suppliers were not only selling 256K DRAMs here at prices below home market quotes but also marketing them at prices below the cost of production — a charge vehemently denied by Japan's industry.

The breakdown of the semiconductor talks meant that the two industry-filed dumping investigations would proceed on schedule. Three days before President Reagan gave the go-ahead on 256K DRAMs, Commerce made its preliminary ruling in the 64K DRAM case, finding fairly significant dumping margins on sales by the major Japanese suppliers. Based on past experience, though, these margins as well as any tentatively identified in the EPROM investigation, where a preliminary ruling was due in early March 1986, would be scaled back during the verification phase of the proceeding. Even if this scenario did not unfold, the future dumping-duty liability of Japanese memory suppliers was expected to be limited because the appreciation of the yen had forced manufacturers to raise their U.S. prices by about 20 percent.

Many U.S. industry executives and analysts greeted news of higher prices for Japanese-made memories with skepticism. Some dismissed the price hikes as public relations ploys designed solely to head off dumping findings. Others were even less charitable, claiming that rising memory prices just validated the argument that once Japanese manufacturers captured the American market for a particular type of semiconductor through predatory pricing, they felt free to raise prices and recover the money lost in the takeover bid. This attitude was one clue that the semiconductor trade issue would continue to be a divisive force in the bilateral relationship in 1986.

Cars

When the Reagan administration maneuvered the Japanese government in the spring of 1981 into limiting U.S.-bound car exports for two years with a third-year option, spokesmen justified the White House's abandonment of its free-trade principles by maintaining that U.S. automotive makers had to have a breather from stiff import competition to fund and implement massive retooling programs. Left unstated was how many years domestic producers needed before they could hold their own in unrestricted competition with Japanese manufacturers. Washington was able to avoid a direct answer in 1983 after Tokyo signaled in the fall that it was prepared to accept a fourth year of limits starting in April 1984. By early 1985, though, the administration could no longer sidestep the question since the U.S. Big Three car makers had just reported a second year of record-breaking profits.

In the spring of 1984 most U.S. industry and trade analysts were betting that the White House would allow the restrictions to die a quiet death in March 1985. Administration support for the restraints, divided from the start, seemed to be eroding steadily. Commerce Secretary Baldrige, long considered the major proponent of limits on Japanese car exports, was the first convert, coming out in March 1984 against a fifth-year extension, but he was soon

joined by USTR Brock. By that summer, however, these officials were backpedaling, saying that the administration would not address the renewal issue until U.S. car makers completed labor negotiations with the United Auto Workers union and their full-year financial results were available.

Sensing the direction in which the White House was moving, the chief executives of Chrysler Corp. and Ford Motor Co. went on the offensive. In an early October letter to President Reagan, Chrysler chairman Lee Iacocca conceded that the U.S. auto industry's recovery had been "substantial" but went on to argue that it was still "fragile." Two more years of Japanese export restrictions were needed to put the recovery on a firm basis, he asserted. This additional breather would provide "a unique window of opportunity" to correct what Mr. Iacocca had repeatedly — and erroneously — portrayed as economic misalignments that gave Japanese exporters an unfair competitive advantage, particularly the undervaluation of the yen and the rebate of Japan's commodity tax on overseas car shipments.

Ford chairman Philip Caldwell sounded a similar theme in a mid-October letter to the president co-signed by UAW president Owen Bieber. "We hope the administration will realize the benefits that the present restraints have had for the U.S. economy and we request that the administration encourage early action by the Japanese to extend restraints to an effective level beyond the present expiration date." To bolster their case for a fifth year of restrictions, the pair cited Ford's new contract with the UAW, which they claimed showed "their joint determination to become competitive" with Japanese auto manufacturers.

General Motors Corp. was noticeably silent on the extension question. The reason why was no mystery: its U.S. small car strategy for the rest of the 1980s hinged in part on obtaining up to 200,000 subcompacts a year from Isuzu Motors Ltd. and 80,000 to 100,000 mini cars annually from its other Japanese affiliate, Suzuki Motor Co., Ltd. With the continuation of Japanese export limits through March 1985 already disrupting this plan, the world's biggest car maker was thought to be ready to take its case against a fifth year of restraints to the White House.

By February 1985 practically everyone in Washington took for granted that Tokyo would not be lobbied to extend the restraints on U.S.-bound car exports for a fifth year. Two years of robust domestic car sales and record-breaking profits left the administration little choice, it was argued. In fact, when the renewal issue was put to a formal cabinet vote at mid-month, not one of the president's top advisers was prepared to make the case for continued restraints.

With the Cabinet Council on Commerce and Trade unanimously recommending that Mr. Reagan not ask Japan for another year of export restrictions, the only questions left were the timing of the formal announcement and whether action on the restraint issue would be linked to progress in the MOSS negotiations (see above). Mr. Reagan was said to agree with his advisers, yet at a late February news conference, he refused to commit himself. The president suggested that his decision hinged on the steps Japan took to improve market opportunities for U.S. exporters of telecommunications equipment and other products — a linkage cabinet officials reportedly opted against.

What little suspense existed was eliminated March 1 when Mr. Reagan announced that he would not ask Tokyo for a fifth year of limits. The president ended up rejecting the option of an explicit trade-off between this move and the MOSS talks, but his decision to return to free trade in cars was clearly designed to promote progress in the market access talks. "In taking this action," the chief executive said, "I hope we can look forward to reciprocal treatment by Japan concerning the high-level discussions under way between our countries in the weeks and months ahead."

The president's decision, which was predictably greeted with applause in Japan and boos from Chrysler, Ford, the UAW and congressional supporters of continued auto industry protection, threw the touchy question of export volumes after March 31, 1985 back to Tokyo. While both the Nakasone administration and motor vehicle exporters had been proceeding on the assumption that the restraint program would end, Japanese government leaders had hoped that Washington would signal how many additional cars could be shipped to the United States without triggering a protectionist backlash. But White House spokesman Marlin Fitzwater emphasized that "there are no hidden deals" with Japan on export numbers.

This set the stage for a month-long guessing game in Washington and Detroit about how many additional cars Japan's automotive makers would export to this country in the year starting April 1. U.S. industry analysts, American car makers, union representatives, administration trade officials and congressional leaders all mapped out different scenarios, but since most people assumed that Japanese auto companies would tailor their U.S. sales strategies to minimize the chances of a backlash, there was something close to a consensus on the level of shipments in the April 1985-March 1986 period.

In this view Japan's top three exporters could live with fairly modest increases in shipments. Their main goal, it was argued, was to have adequate inventories in the United States so that skimpy stocks would no longer cost them sales. Honda Motor Co., Ltd. had the most flexibility of this trio since 150,000 Accords a year were rolling out of its Marysville, Ohio plant. Nissan Motor Co., Ltd. also gained a little maneuvering room with the late March start

U.S. Retail Car Sales, 1981-85
(units)

Manufacturer/Seller	1981	1982	1983	1984	1985
Toyota Motor Corp.	576,491	530,246	555,766	552,981	620,037
Nissan Motor Co., Ltd.	464,805	470,246	521,902	485,298	535,372
Honda Motor Co., Ltd.	370,705	365,865	350,670	374,819	406,413
Mazda Motor Corp.	166,105	163,638	173,388	169,666	211,093
Fuji Heavy Industries, Ltd. (Subaru)	152,062	150,335	156,840	157,385	178,175
Mitsubishi Motors Corp.	0	3,950	32,755	39,104	49,734
Isuzu Motors Ltd.	17,805	15,462	20,731	17,233	26,953
Mitsubishi Motors Corp./ Chrysler Corp.	110,940	102,227	103,569	91,718	105,213
Isuzu Motors, Ltd./ General Motors Corp.	0	0	0	2,077	53,968
Suzuki Motor Co., Ltd./ General Motors Corp.	0	0	0	10,927	30,892
General Motors Corp.	3,796,696	3,515,660	4,053,561	4,587,508	4,607,458*
Ford Motor Co.	1,380,600	1,345,698	1,571,321	1,979,317	2,070,392
Chrysler Corp.	729,873	691,703	841,622	986,998	1,139,936
American Motors Corp.	136,682	112,433	193,351	190,255	123,449
Volkswagen of America Inc.	162,445	91,166	85,045	73,838	77,535
Honda of America Manufacturing Inc.	0	0	50,402	133,601	145,976
New United Motor Manufacturing Inc./ General Motors Corp.	0	0	0	0	5,594
Nissan Motor Manufacturing Corp. U.S.A.	0	0	0	0	39,794
Total Japanese Imports	1,858,913	1,801,969	1,915,621	1,906,208	2,217,860
Total Imports	2,326,376	2,221,398	2,382,799	2,439,848	2,836,973
Total Domestic Makes	6,206,296	5,756,660	6,795,302	7,951,517	8,204,540
Total Market	8,532,672	7,978,058	9,178,101	10,391,365	11,041,513
Market Share of Japanese Imports	21.8%	22.6%	20.9%	18.3%	20.1%

*Includes the Nova made by New United Motor Manufacturing Inc.

Source: *Automotive News*

of Sentra production at its Smyrna, Tennessee factory. The only way Toyota Motor Corp. could expand U.S. sales, however, was by upping exports because all of the output of New United Motor Manufacturing Inc. was earmarked for its partner, GM.

Mazda Motor Corp. and Fuji Heavy Industries, Ltd., the manufacturer of Subaru vehicles, were said to be eyeing slightly bigger increases than their larger competitors. They, too, had had to contend with the problem of limited car supplies. Perhaps more importantly, both companies felt shortchanged by the quota allocation formula in effect since the start of the restraint program, which they maintained had bolstered the already strong U.S. sales position of Toyota, Nissan and Honda.

The wild cards in everyone's forecast were the three Japanese auto companies that build cars for American makers. It was reported that General Motors wanted to source 150,000 subcompacts from Isuzu and 84,000 mini cars from Suzuki over the April 1985-March 1986 period for sale under the Chevrolet nameplate — a big jump from the 30,000 Isuzu vehicles and 17,000 Suzuki-made cars GM was allocated in FY 1984 but still short of its original import plans. For its part, Chrysler had placed a "firm order" for up to 200,000 more cars built by Mitsubishi Motors Corp., which in the year through March 1985 had supplied 87,000 Dodge and Plymouth cars. The Japanese auto maker also wanted to ship more cars to the United States for sale under its own name, as did Isuzu, another relative newcomer to the American market.

Beginning with Japan's FY 1984 shipment ceiling of 1,850,000 vehicles, simple arithmetic indicated that if Isuzu and Suzuki supplied GM with all the cars it wanted and if Chrysler's purchases from Mitsubishi Motors were pegged

Unofficial Quota Allocations, FY 1981-FY 1985
(in units)

Exporter	FY 1981 - FY 1983 Quota	FY 1984 Quota	FY 1985 Quota	Increase FY 1984 FY 1985
Toyota Motor Corp.	516,659	551,792	620,800	12.5%
Nissan Motor Co., Ltd.	456,030	487,040	547,900	12.5
Honda Motor Co., Ltd.	348,631	372,338	428,600	15.1
Mazda Motor Corp.	159,282	173,468	229,700	32.4
Mitsubishi Motors Corp. (including sales to Chrysler Corp.)	112,584	122,612	186,200	51.9
Fuji Heavy Industries, Ltd.	70,014	76,250	117,200	53.7
Isuzu Motors Ltd. (including sales to General Motors Corp.)	16,800	49,500	117,100	136.6
Suzuki Motor Co., Ltd. (for sale to General Motors Corp.)	0	17,000	52,500	208.8
Total*	1,680,000	1,850,000	2,300,000	24.3

*Not included in these figures are the separate quotas on exports of four-wheel-drive vehicles, station wagons and mini vans and on shipments to Puerto Rico. These quotas were estimated at 112,900 units and 95,700 units, respectively, for FY 1985.

to a realistic number, say 125,000, exports of U.S.-bound cars would go up to 2,075,000 units. Adding in some increase in shipments by Toyota, Nissan and Honda and slightly bigger percentage gains for their smaller rivals, the number rose to somewhere between 2.2 million and 2.4 million cars, according to the consensus view.

Most analysts thought that Japan's auto industry could increase car exports to this range without causing a new outbreak of protectionism in the United States, but only as long as sales of American makes remained on the upswing. There was also general agreement right after the White House bucked the restraint issue back to Tokyo that the Japanese government would leave the decision on shipment levels after April 1 to individual manufacturers — at least for the short run to see what would happen. By late March, though, industry watchers were having second thoughts about whether Tokyo was prepared to run the risk of a sudden surge in car exports to this country at a time of heightened tensions in the bilateral economic relationship.

These doubts were warranted. On March 28 MITI Minister Keijiro Murata announced that Japan would continue the restraints on U.S.-bound car exports for one more year but that the shipment ceiling would be raised from FY 1984's 1.85-million-unit level to 2.3 million vehicles. The extra 450,000 cars, MITI spokesmen said, would allow Japanese companies to rebuild their depleted U.S. stocks. The increase would also permit Isuzu and Suzuki to meet more of their export commitments to General Motors and enable Mitsubishi Motors to expand deliveries to Chrysler.

The Nakasone government knew that whether it extended the export restrictions for another year or allowed them to expire as planned, some group — American auto industry executives, union representatives, Reagan administration policymakers, congressional leaders, Japanese car company officials — was sure to cry foul. What it did not anticipate was that its decision would be denounced in all quarters.

Spokesmen for Chrysler, Ford and the UAW all used the word "flood" to describe the new export ceiling, while "unacceptable" was the most frequently heard adjective among congressional supporters of U.S. auto industry protection. But what caught Tokyo off-guard was the critical response of the Reagan administration, which seemed to feel that it had been betrayed. This reaction went beyond the obvious question of whether Tokyo viewed continued restraints as a substitute for efforts to improve market opportunities in Japan for American exporters — a trade-off MITI Minister Murata denied. It appeared to reflect the feeling that the Japanese government had misread Washington's signals on what to do about car exports after March 31.

Washington observers had different interpretations of what the White House expected of Japan. One school argued that while the administration decided not to ask for a fifth year of restraints, it had hoped that Tokyo would continue to limit exports — but at a low level — as a sign that Japan was willing to take actions to stem the ballooning bilateral trade deficit. Another view was that the president was really telling Japan that Washington wanted the export limits to die and that Tokyo had embarrassed the White House by not picking up on his cue.

To make matters worse, some administration officials charged that the new export ceiling represented no restraint at all since the Japanese automotive industry did not have

the capacity to assemble more than 2.3 million cars for shipment to the United States over the coming year. MITI officials were quick to counter this argument, which had been raised as well by a few U.S. analysts. The eight companies selling cars in this country could turn out enough vehicles to boost exports to the 2.6 million-2.8 million range, these spokesmen said.

Having opted to hike the export ceiling, MITI had to figure out how to allocate the additional quota among exporters, all of which were unhappy with the decision to extend restraints for a fifth year. The ministry also had to find a way to quell the outcry in Detroit and on Capitol Hill that greeted news of the higher limit. The solution: earmarking three-fifths of the extra 450,000 cars for sale by Japan's five smaller exporters, with the lion's share going to GM's two affiliates and to Mitsubishi Motors, which is partly owned by Chrysler.

While the trade ministry once again refused to confirm publicly how many cars each company could export to the United States, auto industry sources estimated that General Motors and Chrysler would get between 280,000 and 290,000 Japanese-made cars during the April 1985-March 1986 period, up from 134,100 vehicles in FY 1984. Suzuki's allotment was raised from 17,000 to 52,500 units, with all of these cars going to GM for sale as the Chevrolet Sprint. Isuzu, allowed to export 49,500 subcompacts here in the year through March 1985, including 29,500 cars carrying the Chevrolet Spectrum nameplate, would be able to ship 117,100 units in FY 1985 to GM and its own U.S. dealers. For its part, Mitsubishi Motors could ship 186,200 cars compared with 122,612 units in the April 1984-March 1985 period, when Chrysler received 87,600 cars for sale by Dodge and Plymouth dealers.

Steel

The ongoing efforts of U.S. steel mills to win protection from what they claimed was a flood of dumped and subsidized foreign steel coming into the American market insured that steel trade would remain an irritant in the bilateral relationship during the mid-1980s. Ironically, neither Japanese competitors nor European suppliers, the domestic industry's usual nemeses, were the primary targets this time around. U.S.-bound shipments of most carbon steel products from the European Community were limited for three years under an October 1982 agreement, while Japanese exporters, on the defensive because of the combative mood of U.S. steel makers, were monitoring their shipments. Yet both Japanese and European mills got caught in the crossfire between American manufacturers and Third World steel exporters that had filled the gap left by curbed shipments from this country's two biggest foreign steel suppliers.

In late 1983 the domestic industry set in motion a two-pronged Washington lobbying campaign to contain the U.S. market inroads of developing country steel exporters. On Capitol Hill steel executives threw their weight behind a bill that would limit total imports of carbon and specialty steel products to 15 percent of apparent U.S. supply for five years. At the same time they continued to press their case for protection at the White House. Here, though, the industry leaders broke ranks over tactics.

Bethlehem Steel Corp., the number-two producer, came out in support of an escape-clause investigation under Section 201 of the 1974 Trade Act as the fastest and least expensive way of limiting imports from Third World suppliers. United States Steel Corp. vigorously opposed this action. It argued that a 201 investigation, which would cover steel imports from all sources, could cause the EC to terminate its restraint program — an option it had if any American steel maker that was a party to the agreement filed a trade complaint. Japan might also be tempted to abandon its informal shipment curbs. The less risky and potentially more effective strategy, the top U.S. steel maker was said to have argued, was to file additional antidumping and countervailing-duty complaints against unfairly traded imports while continuing to lobby for quota legislation.

Afraid as well that a 201 petition would lead to the collapse of the steel arrangement with the European Community, top Reagan administration trade policymakers repeatedly tried to persuade Bethlehem not to file. The company was not deterred. Joined by the United Steelworkers of America, the nation's second-largest steel producer filed a 201 complaint with the International Trade Commission in late January 1984, asking that steel imports be limited to 15 percent of the market for five years so that American mills could generate the profits needed to invest in new facilities. At a press conference Bethlehem chairman Donald Trautlein said the petition was designed to complement the quota legislation pending before Congress, adding that the steel maker would be satisfied with import limits achieved either way. He also suggested that a global quota could be arranged to incorporate the EC's steel restraint accord and Japan's informal curbs.

Bethlehem's gamble paid its first returns in mid-June. By a 3-to-2 vote the ITC concluded that increasing imports in five major product lines were a substantial cause of the U.S. steel industry's problems. Found to be injuring domestic mills were semifinished products (ingots, blooms, billets, slabs and sheet bars), plates, sheets and strip, wire and wire products and structural shapes, which together represented roughly 70 percent of both the volume and the value of 1983 imports. The number-two steel maker and its co-petitioner failed to win the across-the-board injury determination they sought, however. On wire rods, bars, rail products and pipes and tubes the commissioners decided that Bethlehem had not demonstrated injury from imports.

Bethlehem's calculated risk yielded additional dividends a month later when the ITC recommended that the president

impose quotas, extra duties or tariff quotas for five years on the five product groups found to be injuring American mills. The three commissioners voting for the complex relief package suggested, however, that protection be conditional on an industry commitment to improve competitiveness through steps like plant modernization, changes in management practices and labor concessions. The ITC's chairwoman and vice chairwoman, while supporting the thrust of the linkage concept, broke ranks with their colleagues on the remedy issue, just as they did earlier on the injury question. Since the industry's loss of sales and jobs was due chiefly to factors other than increasing imports, they argued, protection was not justified.

The relief package crafted by the ITC majority featured quotas on sheets and strip (including separate limits on hot-rolled, cold-rolled, galvanized and other sheet and strip products), plates, structural shapes and wire; higher tariffs on wire products; and a tariff quota for semifinished steel products. The recommended quantitative restrictions, which were actually combinations of minimum import volumes and maximum shares of U.S. apparent consumption, were based on 1979-81 data. On balance, market analysts estimated, the suggested floor-ceiling formulas would help foreign producers during periods of slack demand and hurt them in an expanding economy.

Foreign reaction to the ITC's relief recommendation was predictably negative. "Restricting fairly traded imports from Japan, which are not injuring the American steel industry, runs counter to American trade law," argued a spokesman for Japanese steel exporters. Representatives of the European steel industry warned that additional import protection for steel could endanger the accord limiting U.S.-bound shipments from Europe. The recommended remedy package, added the American Institute for Imported Steel, would "irreparably damage" U.S. steel users by raising their costs at least $100 a ton and diminishing their competitiveness in the world market.

President Reagan had until late September to decide what protection, if any, to give domestic steel producers. With the presidential election only six weeks after the deadline and big blocks of electoral votes at stake in steel-producing states, political and trade analysts in Washington generally expected Mr. Reagan to grant some measure of relief to the U.S. industry.

Avoiding the blatantly protectionist route, the president declined to accept the ITC's recommendation and instead opted for export restraint agreements behind a smokescreen of negotiating "surge control arrangements or understandings." These surge controls, which the administration sought to implement within 90 days and which could last up to five years, were expected to roll back total imports of finished steel products to 18.5 percent of the U.S. market. Together with a 1.7-million-ton cap on shipments of semifinished steel, foreign mills would be limited to approximately 20 percent of the American market.

Mr. Reagan's policy was clearly contradictory. His pre-set level of import penetration was at odds with his position that market forces should determine foreign producers' share. Yet partisan observers called the move politically brilliant because it projected an image of anti-protectionism while leaving the president plenty of latitude to protect the domestic industry.

Long before negotiators for Washington and Tokyo sat down to work out the details of a restraint agreement, industry and trade watchers were saying that the talks would be tough. The Japanese steel industry resented being lumped publicly with steel exporters from countries guilty of dumping or subsidization when it had had a clean record in recent years. Corporate executives as well as government officials were also irritated that the Reagan administration was no longer willing to take Japan's word that shipments to the United States would be monitored closely to prevent any market disruption. If an informal understanding with Canada was acceptable, they implied, why wasn't a similar arrangement with Japan?

The Reagan administration's threat that antidumping and/or countervailing-duty cases would be brought against countries that failed to conclude formal export-restraint agreements was not expected to alter Japan's negotiating position; its name was noticeably missing from the list of countries suspected of unfair trade practices that the White House released in connection with the announcement of its new steel program. The possibility that a complaint under Section 301 of the 1974 Trade Act might be filed against Japan on the grounds that its closed market had led to the diversion of Korean steel to the United States was also unlikely to make Tokyo more amenable to a formal restraint agreement. As industry officials pointed out, Japan bought as much steel from Korea in 1983 as the United States did.

The talks lived up to their advance billing. The initial round of negotiations, held in late November, ended in a stalemate. Deputy USTR Robert Lighthizer would not budge from his demand that Japanese steel mills slice their share of the American market to the 5.1 percent level of 1983, when purchases from Japan shrank to the lowest volume since 1965. Takashi Nonouchi, director general of MITI's basic industries bureau, was equally insistent that the mills were entitled to no less than their traditional share of the U.S. steel business, which averaged close to 6.3 percent for the previous 10 years.

With the talks deadlocked, Mr. Nonouchi made a hurried trip back to Tokyo for consultations. He returned to Washington in early December accompanied by Kazuo

Wakasugi, MITI vice minister for international affairs, who told USTR Brock that Japan was prepared to accept a restraint agreement as long as it was reasonable. This call for flexibility fell on deaf ears as the American side continued to hold out for a 5.1 percent market share after Mr. Nonouchi offered to limit Japanese exports to 5.9 percent of U.S. demand. Moreover, Mr. Lighthizer again pressed for limits on 47 specific steel products in addition to the overall cap — an arrangement the Japanese negotiating team rejected as unacceptable because it would limit the ability of exporters to respond to shifts in U.S. demand. The U.S. official also countered Japan's proposal of a one-year restraint pact starting January 1, 1985 by renewing his demand for a five-year agreement retroactive to October 1, 1984.

Anxious to have something in hand before President Reagan's self-imposed mid-December deadline for the negotiation of restraint arrangements, trade officials agreed to continue their discussions. By the end of the third day they had come to terms on the broad outlines of an accord. The American side accepted a new compromise offer from Japan to limit shipments to 5.8 percent of apparent domestic demand, with exports divided into six broad categories. Washington also acquiesced to Japan's position that continuation of the restraints was conditional on the absence of trade and antitrust suits against Japanese steel exporters.

Filling in the blanks of this understanding took three more rounds of contentious subcabinet-level negotiations, including a 12-day marathon in February 1985. On March 13 the two sides finally ironed out the details of an arrangement to cap U.S.-bound exports of Japanese steel to 5.8 percent of the American market. The agreement contained few surprises. The quantitative limits were put in place for five years, but in a partial bow to the Japanese side, which had argued strenuously in the later bargaining sessions for no more than three years of restrictions, the pact would be reviewed at the end of 1985 and again in December 1987. Moreover, to overcome Tokyo's opposition to an agreement retroactive to October 1, 1984 — a major sticking point because of heavy Japanese shipments during 1984's final quarter, U.S. negotiators finally conceded to make allowance for first-year exports beyond the pact's provision for advanced use or carryover of up to 8 percent of each year's global quota.

Despite pleas from Japanese mills for an agreement that would allow them to respond to shifts in U.S. market demand, virtually all steel exported to the United States was subjected to one type of restraint or another. Six broad categories of products were restricted — sheets and strip, plates, structurals, bars, pipe and tubing, and wire and wire rods, as were seven subcategories: cold-rolled sheets, coated sheets, cold-finished bars, structural pipe, line pipe, oil-country tubular goods, and wire rods. To introduce some flexibility into the arrangement, Japan, with the consent of the United States, could change the mix of categories subject to quota by up to 5 percent a year and shift shipments of products within a category by as much as 7 percent annually.

A major question going into the last round of talks was how the two sides would handle the long list of other product lines that Washington argued should be limited. The compromise was to monitor exports of 18 products. If shipments of any one of these products increased by more than 10 percent from one restraint year to the next, the United States had the right to put the item under quota. On the "watch list" were cold-rolled strip, electrical sheets, stainless sheets and strip, black plate and heat-resistant steel, tin plate, tin-free steel, alloy plate, stainless plate, hot-rolled carbon bars, hot-rolled alloy bars, shapes under 3 inches, standard pipe, pressure tubing, mechanical tubing, stainless pipe and tubing, carbon and alloy wire, stainless wire and other wire products, and rail and track accessories.

What was interesting about this list was the extra protection given the American specialty steel industry. Domestic makers had complained loudly about the limited product coverage of the orderly marketing agreements negotiated in 1983 with Japan and other major suppliers of stainless and alloy steel. They had been equally vocal about the fact that flat-rolled products were subject to higher tariffs, not quotas. By flagging a number of Japanese-made specialty steel products for monitoring, Washington obviously hoped to head off some criticism from the U.S. industry.

One of the few surprises of the pact was that Tokyo gave in to the administration's last-minute demand for a ceiling on exports of fabricated structural products. Under a five-year agreement separate from the main accord, Japanese steel mills were to limit shipments of welded H beams and bridges, towers and similar structures to 100,000 tons annually. This cap, U.S. producers hoped, would prevent shifts in Japan's export mix toward higher value-added goods. Similarly, American makers of semifinished steel products expected some import relief since Japanese shipments would be held to 100,000 tons a year.

The steel restraint arrangement put an end to six months of public bickering between Washington and Tokyo. But it left a reservoir of ill will in the Japanese industry, which was convinced that it had been made the scapegoat for the problems of U.S. steel mills.

Machine Tools

At the same time that Bethlehem Steel was gambling that it could win help for U.S. steel mills, it appeared that the domestic machine tool industry's controversial bid for

import restrictions on national security grounds might also succeed. In March 1983 the National Machine Tool Builders Association had appealed to the White House for across-the-board protection from Japanese manufacturers, their chief competitors, and other foreign suppliers for security reasons. Tapping little-used Section 232 of the 1962 Trade Expansion Act, the trade association argued that the rising tide of imports threatened to cripple an industry critical to this country's "defense and deterrence posture." To maintain sufficient production capacity for national emergencies, NMTBA asked the government to roll back aggregate machine tool imports to 17.5 percent of the U.S. market for five years.

In a late February 1984 report to the White House that was never made public, Commerce Secretary Baldrige recommended that stiff quotas be slapped on imports in a number of product lines, including, it was reported, numerically controlled lathes and machining centers, the mainstays of Japan's shipments to the United States. In siding with the trade association, Mr. Baldrige set the stage for a confrontation with other department and agency heads, none of whom had had a chance to review the report before it went to the White House.

Commerce's report was sent back to the department without being considered by the full cabinet or the Economic Policy Council. The ostensible reason was to incorporate the results of a pending National Security Council study on industrial mobilization. In reality, though, the president's advisers were deeply divided over the wisdom of granting relief to the machine tool industry on national security grounds. Even Defense Secretary Caspar Weinberger was said to be cool to the idea. The reaction of other policymakers reportedly ranged from lukewarm support to outright opposition.

Opponents were worried that curbs on machine tool imports for national security reasons could trigger foreign retaliation against U.S. exports, perhaps on similar grounds, as well as spur a spate of pleas from other industries seeking import protection on this basis. There was also recognition that stiff import restrictions were a short-sighted solution to the machine tool industry's problems, as even some builders conceded. Foreign manufacturers and their U.S. allies also scored points with their argument that the quotas proposed by Mr. Baldrige would lead to higher prices for imported machine tools and/or cut off the supply of some specialized equipment available only from overseas builders.

With President Reagan under no statutory deadline to decide whether to give machine tool makers the sweeping protection they wanted, the divisions within his cabinet buried the NMTBA's 232 petition. Periodic attempts by various senators and congressmen to resurrect the complaint were always frustrated, reportedly by the staff of the National Security Council. Machine tool builders finally got a break at the end of 1985. In exchange for Republican support for the tax reform plan up for a vote in the House of Representatives, Mr. Reagan promised in mid-December to have the cabinet consider the trade association's case. This review took place in 1986's first quarter.

Textiles and Apparel

Japan was not a target of the unsuccessful 1985 congressional drive to roll back U.S. imports of textiles and apparel (see Part II). But the touchy issue of Japanese textile and apparel shipments to this country did crop up late in the year simply because the bilateral agreement that had regulated trade in yarn, fabrics, made-up articles and clothing since 1982 was scheduled to expire December 31. When negotiators finally sat down right before Christmas to work out the terms of a new arrangement, however, they found themselves far apart.

Tokyo's alleged unwillingness to crack down on illegal transshipments of third-country textile and apparel products through Japan to the United States was apparently the main stumbling block to agreement on a new bilateral accord. Over the previous year Reagan administration officials had increasingly complained that tighter U.S. quotas on imports from Taiwan, Hong Kong and Korea — the Big Three import suppliers — plus origin rules for textiles and apparel introduced in 1984 were turning Japan into a major conduit for illicit U.S.-bound shipments. They maintained that some exporters in Asian countries that had exhausted their U.S. import allocations for the year improperly used Japanese front companies to ship orders quota-free to American customers.

Ministry of International Trade and Industry officials acknowledged that some transshipments had occurred but disputed U.S. claims that Japan was becoming a major route for illegal deliveries. They similarly challenged Washington's assertion that the Japanese government was doing nothing about the problem. The Reagan administration had been pushing Tokyo to set up an official visa system for Japanese textile and apparel exports to help U.S. Customs authorities spot fraudulent shipments more easily when they arrived at American ports, but MITI's negotiators rebuffed these attempts. Their resistance, it appeared, reflected concern that a system designed to authenticate the origin of Japanese textile and apparel shipments could be used to further limit the volumes Japanese manufacturers were allowed to export under the bilateral agreement.

Textile negotiators for the United States and Japan were also said to be at odds over 1986 quota levels for Japanese-made products already subject to controls. Trade sources

reported that Washington was demanding cuts as deep as 40 percent in base volumes in the wake of President Reagan's mid-December veto of the textile-apparel quota bill.

The product coverage of the new bilateral pact was another major sticking point in the discussions. The 1982 agreement initially restricted shipments in 11 textile and apparel categories — the same number controlled under the 1979 bilateral, but 11 other products had been added to the quota list in 1984 and 1985. If the Reagan administration had its way, however, quantitative limits would reportedly be slapped on 16 more categories, pushing the total up from 22 to 38. Ten of the 22 textile and apparel products under quota at the end of 1985 were cotton goods, seven covered manmade-fiber categories and five limited wool products.

These differences proved to be unbridgeable until late in 1986. In the meantime, Japan voluntarily restricted U.S.-bound shipments in a reported 25 textile and apparel categories. It also introduced a visa system for polyester and other continuous noncellulosic fabric, the biggest and most sensitive export category.

Aviation

There was little chance in the mid-1980s that aviation rights would lose the distinction of being the most intractable yet least publicized dispute in the bilateral economic relationship. The interim three-year air transport pact initialed in the summer of 1982 resolved some of the aviation issues that had long divided negotiators for the two countries, but it skirted a number of highly contentious matters. Among these were Washington's demands for clarification of the rights of American carriers to fly beyond Japan and for the designation of additional U.S. airlines to serve Japan. A U.S.-sought reduction in fares for all trans-Pacific flights was also left unaddressed. So were Japan's demands for more beyond rights for Japan Air Lines in the United States and for JAL service to a larger number of American cities.

Transportation officials met four times over the December 1983-February 1985 period to tackle these and other aviation issues. At each meeting, though, negotiators had to cut short discussion of what constituted an equitable bilateral aviation accord to deal with more pressing operational matters. The main topic on the agenda for the first session was Tokyo's refusal to grant Continental Air Lines and its Air Micronesia affiliate nonstop operating rights on the Guam-Tokyo route. Three months later negotiators had to grapple with Japanese charges that United Airlines and Northwest Orient Airlines were offering unfair promotional fares.

A new operational problem cropped up at the aviation talks held in September 1984: U.S. delays in approving the April 1, 1985 start of trans-Pacific service by Japan's first international air freight carrier. Japanese negotiators maintained that Nippon Cargo Airlines had the right under the bilateral air transport agreement to launch operations. The American side was noncommittal, in part, observers suggested, because Tokyo had blocked Japanese landing rights for United Airlines for four years. Flying Tiger Line's strong opposition to NCA's February 1984 application was also said to have influenced the U.S. stance. The world's largest air freight company had long argued that it would be at a competitive disadvantage in the fast-growing trans-Pacific cargo business if NCA entered the market since the owners of the new cargo line included the major Japanese freight forwarders.

By the time formal aviation talks resumed in late February 1985, it was clear that Washington was angling for a trade off: NCA would be permitted to make its planned six round trips a week between Tokyo and New York via San Francisco if Japan allowed more U.S. airlines to fly to Tokyo and added flights for some of the five American carriers that were already in the market. Japan's Ministry of Transportation, which had earlier hinted at retaliation if NCA's application did not win quick approval, was prepared to accept this deal, but the discussions ended March 1 without an accord because negotiators from the State and Transportation Departments had to return to Washington for consultations.

It took the two sides three more sessions to work out the details of an agreement to expand bilateral air services, in part because the Commerce Department and the Office of the USTR were maneuvering to hold the pact hostage to Japanese concessions in other areas of economic interest to the United States. On April 30, though, negotiators for the United States and Japan initialed an interim arrangement that allowed NCA to begin trans-Pacific service immediately, enabled each country to designate three more direct routes across the Pacific in 1986, and approved additional service between Japan and Micronesia.

The new arrangement, which would be folded into any agreement revising the 1952 pact that governs U.S.-Japan air transport services, included the following major provisions:

- Nippon Cargo Airlines could make six round-trip all-cargo flights a week between Tokyo and New York via San Francisco starting May 1, 1985. In April 1986 and in following years, the international air freight carrier would be allowed to increase the frequency of its service in line with the expansion of overall U.S.-Japan air cargo traffic during the previous calendar year.

- Both the United States and Japan could designate three additional trans-Pacific routes for nonstop combination

passenger and cargo service by existing or new carriers starting in April 1986. Route options included Tokyo-Honolulu, Nagoya-Honolulu, Tokyo-Los Angeles, Tokyo-Portland and two new U.S. destinations from Tokyo. Service on the new routes would be limited initially to 10 round-trip flights a week for the carriers of each country, increasing to 18 weekly flights in April 1987, 20 flights a week the following year and 21 weekly flights beginning in April 1989.

This part of the interim arrangement provided some long-sought market opportunities for American carriers. Five American airlines — Pan American World Airways, Northwest Airlines, United Airlines, Continental Air Lines' Air Micronesia affiliate and Flying Tiger Line — then served Japan from the United States, making 116 passenger and 45 cargo flights a week. With the new agreement the door was open for up to three new carriers to enter the market. Among the carriers vying for selection were Delta Air Lines, which was interested in starting direct service to Tokyo from Atlanta, American Airlines, which wanted to inaugurate flights from Dallas, and Continental Air Lines, which planned to fly out of Houston.

On paper, at least, the new agreement also cleared the way for All Nippon Airways, Japan's major domestic carrier, and its competitor, Toa Domestic Airlines, to begin scheduled service to the United States. It was not known, however, whether the Japanese government would authorize one or both of these airlines to serve the American market. The Ministry of Transportation could decide to give the three additional routes to Japan Air Lines, which at the time operated 68 passenger and 21 cargo flights a week to this country. (Neither Nippon Cargo Airlines nor its route counted against Japan's ceiling.)

- At its option either country could tap a new carrier to provide small package express service on an exclusive basis starting in April 1987. This alternative, if selected, would replace combination passenger and cargo service on one of the three additional trans-Pacific routes. This option was expected to benefit Federal Express, which was anxious to expand its small package business to Japan.

- Effective immediately both the United States and Japan could designate two carriers for the Osaka-Guam/Saipan route and one each for the Nagoya-Guam/Saipan run and the Naha (Okinawa)-Guam/Saipan route. New service to Fukuoka from Micronesia by one airline from each country would be authorized in April 1987, followed a year later by the designation of a second American and Japanese carrier on the Tokyo-Guam/Saipan route. Moreover, airline capacity on the routes between Micronesia and Tokyo, Osaka and Nagoya would be expanded by 20 percent starting in May 1985, with further increases in each of the next two years.

Air Micronesia, the only American carrier operating between Guam/Saipan and Japan, was expected to be the main beneficiary of these provisions since the airline's expansion in the lucrative Micronesia-Japan market had been stymied by restrictions on its Japanese landing rights, which were limited to Tokyo and Nagoya, and the type of equipment it could use. It was anticipated that All Nippon Airways would join JAL on the Micronesia routes when two carriers were permitted. How much additional service it would be allowed to provide probably depended on whether it got the go-ahead for one of Japan's new trans-Pacific routes.

With the deadlock over operating rights for Nippon Cargo Airlines broken, negotiators for the United States and Japan had hoped to get back to the hard job of revising the 1952 bilateral air services agreement. These discussions were supposed to be wrapped up by the fall of 1985, but this schedule went out the window after a new operational problem sidetracked Washington and Tokyo. The problem this time around was Pan Am's April 1985 decision to sell its Pacific operations to United.

Japanese aviation authorities maintained that the 1952 agreement made no specific provision for the transfer of landing rights from one airline to another. They therefore advised the Reagan administration that approval of United's application to operate 56 flights a week into Japan starting in late January 1986 was contingent on U.S. traffic concessions for Japanese carriers. From the start, though, Washington had ruled out any trade-off, insisting that the U.S.-Japan air transport accord obligated Tokyo to shift Pan Am's landing rights to United. With the Japanese side refusing to budge, 1985 ended with the talks deadlocked.

Fishing

With the United States trying to rebuild the domestic fishing industry by first capping and then slowly reducing what are known as the TALFF quotas — total allowable foreign fishing quotas — and Japan's fishing industry dependent on American waters for the majority of its deep sea catch, fishing disputes were a fixture of the bilateral relationship in the mid-1980s. The period started out badly for Japanese fishing companies when the first of three quota allotments for 1984 was pared back significantly from the previous year's. Japan had hoped to maintain the allocation at 1983 levels in return for meeting the cooperation requirements outlined in the 1982 U.S.-Japan Governing International Fisheries Agreement. But the United States dashed those hopes, citing an increase in domestic fishing capacity. A more likely cause was irritation with Japan's continued protests against the restrictions issued by the International Whaling Commission (see below).

The release of the second portion of the 1984 quota was also bad news for Japanese fishermen: a 10 percent

reduction from the expected amount on the grounds that Japan was not cooperating with U.S. observers attempting to cover foreign fishing activities. But the final installment of the annual quota, announced by the State Department at the beginning of July, contained an unexpected bonus — an extra 105,800 metric tons of all species within the 200-mile U.S. Fishing Conservation Zone. This hike brought Japan's total 1984 allocation up to 1.1 million-plus metric tons, just 5.6 percent short of 1983's total.

Following the recommendations of the North Pacific Fishery Management Council (a quasi-governmental body that regulates fishing within Alaskan waters), U.S. officials announced in January 1985 that Japan's first-half 1985 TALFF quota would be cut by more than 50 percent. This setback reflected late 1984 charges by the council that Japanese fishermen were systematically concealing overfishing in American waters.

Japanese fishermen were shocked by this drastic move, especially since they had just negotiated the purchase of 1 billion pounds of American fish products and agreed to permit U.S. processors to market fish meal directly in Japan. American fishing firms appeared before the council on Japan's behalf, and the regulatory body quickly restored some of the cuts as the overfishing investigation turned up no evidence of a conspiracy.

The State Department also adopted a more conciliatory stance, announcing in September that Japan's quota for fish taken within the 200-mile U.S. economic zone would be increased for the remainder of the 1985 fishing season because of greater cooperation with American fishermen. Japanese boats would be allowed to take an additional 134,400 metric tons of fish, bringing the total for the year to the 900,000 metric tons sought by Japan.

While maneuvering to maintain access to the U.S. 200-mile economic zone, the Japan Fisheries Association was also waging a fight over the cost of this access. In a suit filed at the end of January 1984, the trade association charged that the 1984 schedule of fishing fees for foreign countries operating in the FCZ violated the U.S. Fisheries Conservation and Management Act. The suit asked the U.S. District Court for the District of Columbia to issue a temporary injunction enjoining the National Marine Fisheries Service from collecting the fishing fees, which are designed to recoup the costs of administering the fisheries act. It also sought a review and reform of the fee schedule.

The problem in JFA's view was that both the fishing fee total and its allocation by country were calculated incorrectly. The Fisheries Service stood by its admittedly complex computations, which it insisted were fair and correct. Moreover, the agency felt it had satisfactorily responded to the complaints JFA had made during the public comment period between the initial and final fee schedule announcements — an assertion JFA disputed.

In early April 1984 JFA announced that it had reached an out-of-court settlement with the U.S. government that would reduce the fees charged all foreign fishing interests from $59 a metric ton to $30 a metric ton for flatfish caught in the Bering Sea and Aleutian Straits, while leaving them at the original levels for flatfish caught in the Gulf of Alaska. The trade association calculated that the new two-tier fee schedule would save its members $1.2 million or about 16 percent of what Washington had initially tried to collect.

The compromise settlement offered advantages for both sides. JFA got fees on 80 to 90 percent of its flatfish catch reduced in such a way as to avoid antagonizing American fisheries authorities. At the same time the U.S. government was able to hike its fees, although not by as much as it originally had penciled in. Moreover, both sides benefited by avoiding a high-visibility trial that would only have served to encourage political posturing over what was basically a question of law.

Whaling

Japan's whaling activities also remained a flash point in the 1984-85 period. Against the background of a global conservation movement to protect marine mammals, the U.S.-led bloc of the International Whaling Commission had finally achieved a ban on commercial whaling at the 1982 annual meeting. By a three-fourths majority the commission instituted a moratorium effective at the end of the 1985 season, allowing a three-year period to facilitate the phase-out of workers. Japan and other whaling nations, however, filed objections to the moratorium.

The IWC's rules allow a country to exempt itself from commission actions. Since the organization has no authority to issue sanctions against members that file such objections, it is up to individual non-whaling countries to decide how they want to respond. In this country conservation groups managed to have two provisions inserted into U.S. fishery laws — the Pelly amendment to the Fishermen's Protective Act and the Packwood-Magnuson amendment to the Fisheries Conservation and Management Act — that would penalize whaling countries if they failed to observe IWC rulings.

Already threatened by the IWC's pending commercial whaling ban, Japanese whalers received another blow when the commission slashed Japan's 1984 Minke whale quotas by 36 percent, accepting conservationist arguments that existing levels of catches constituted a grave threat to the species' survival. The Japanese delegation to the late June IWC meeting walked out, and Tokyo filed an objection after

failing to strike a compromise. This put the White House on the spot. So did the mid-1984 decision by Japanese whalers to defy the IWC's ban on harvesting sperm whales. Since it did not want to call attention to the objection and so fan the protectionist fires already burning in Congress, the administration began negotiations with Tokyo. Environmental groups considered this move a clear violation of U.S. fishery laws and filed a suit seeking to force Commerce Secretary Baldrige to invoke the sanctions contained in the Pelly and Packwood-Magnuson admendments.

The suit led to a flurry of discussions between Washington and Tokyo beginning in mid-October and ending with a compromise in early December. In return for withdrawing its objection to the sperm whaling ban by mid-December and phasing out such activities by 1988, Japan would be permitted to catch up to 400 sperm whales in the 1984 and 1985 seasons and up to 200 in the remaining two years before the moratorium's activation. In addition, though, Tokyo had to withdraw its objection to the coming ban on all commercial whaling activities by April 1, 1985. If all these conditions were met, Japanese fishermen would be allowed to continue fishing within the U.S. 200-mile economic zone. Despite some confusion about the agreement, both sides were relieved that no drastic actions had to be taken.

Their relief was short-lived since the Commerce Department and Japanese whalers lost three rounds in the legal battle that conservation groups had set in motion. In early March 1985 U.S. District Court Judge Charles R. Richey handed down an unambiguous ruling: the Secretary of Commerce "had a clear and nondiscretionary duty" to certify that Japan was reducing the efficacy of the IWC ban and it therefore must suffer the "consequences as set forth by the above-mentioned statutes." A three-judge appeals court panel later agreed with Judge Richey; subsequently, the full appeals court declined to review the decision. Commerce Secretary Baldrige assured Tokyo that the attorney general was prepared to move the case to the U.S. Supreme Court, but 1985 ended without a settlement of the dispute.

Unitary Tax

Japanese government officials and business leaders became much more vocal in their opposition to the unitary system of taxation during the 1984-85 period, attacking it as an inherently unfair, extra-territorial process. Under this method, applied by 14 states as of 1983, subsidiaries of a company, whether domestic or foreign, are subject to a state corporate tax based on the worldwide earnings of the parent. What really irked the two Japanese groups was the unwillingness of the White House to work for the repeal of the unitary tax or even its modification. The Reagan administration had set up a working group headed by Treasury Secretary Regan in 1983 to study the unitary tax issue, but the task force ruled out a repeal effort in early December, citing court cases upholding the tax's constitutionality, including a June 1983 Supreme Court decision on California's system, and the prerogatives of states in internal economic affairs.

Tokyo was dismayed by the task force's decision. So was the Japan Federation of Business Organizations (Keidanren), which sent two delegations to the United States in 1984's first half to lobby for the repeal of the unitary tax. Calling the method the "biggest obstacle" to continued Japanese investment in this country, the group intimated that existing investments in some states were in jeopardy while future investments might be diverted to states without a unitary tax or suspended altogether.

Meanwhile, the presidential task force continued to meet behind closed doors. The difficulties in resolving the thorny unitary tax issue became apparent May 1, 1984 when Treasury Secretary Regan simply declared victory and settled for a limited consensus on some issues while outlining the problems with others. The group was able to agree on two points:

- States should utilize the "water's-edge" approach in calculating the unitary tax. This would subject a portion of a company's national earnings to state corporate taxes but its international operations would not be liable.

- In return for the elimination of global apportionment, the federal government would help states enforce existing tax laws. This included additional federal funding to increase enforcement by the Internal Revenue Service and other Treasury Department offices.

Significant disagreements remained on other issues, however. These centered on the treatment of corporate dividends received by a U.S. company from a foreign subsidiary. Under the unitary method dividends paid by one corporation to another within a business group are ignored. The working group offered several alternatives to deal with this question, but agreed to leave any action to individual state legislatures.

From Japan's perspective, the solutions offered by the working group represented something of a victory. The two Keidanren delegations had made it clear that the businesses they represented had no objections to the water's-edge unitary tax system. Their concern was the extension of those principles beyond U.S. shores since it would increase their potential tax liabilities several times over.

At the end of July 1984 Mr. Regan presented a series of options to the president: a water's-edge unitary tax combination for both domestic and foreign-based

companies; increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability; and a competitive balance for U.S. multinationals, foreign multinationals and purely domestic businesses.

The treasury secretary vowed to provide increased federal enforcement immediately to encourage states to eliminate what he termed "this irritant to international commerce." Mr. Regan warned, however, that if states did not act by July 31, 1985 to move in the direction outlined by the report, he would recommend federal legislation to authorize administrative actions to implement the water's-edge concept.

Individual states had until the end of August 1984 to review the task force's recommendations and submit their own proposals. Not surprisingly, most comments were negative due to Mr. Regan's threat to usurp local prerogatives. Although spokesmen in many unitary tax states expressed support for modifications of the tax, it was clear that they sought to institute changes at their own pace rather than under the threat of preemptive federal action.

In fact, it was nearly a year after the task force released its report that any official U.S. move was made. In an effort to offer an incentive to states willing to shed the controversial tax, Treasury Secretary Baker proposed in mid-1985 to provide states not using this method of corporate taxation with information on how multinational corporations calculate their taxes. But the real break came in early November when President Reagan finally signaled that the administration would support legislation to prohibit states from using the worldwide unitary tax method.

Reactions to the president's decision were predictable: unitary tax supporters, outraged by the action, decried the assumption of state prerogatives by the federal government, while anti-unitary tax forces applauded the move. Officially, the Japanese government assumed a wait-and-see posture, but the action certainly had to satisfy Japanese private-sector groups that had never abandoned hope for administration-sponsored legislation despite a multitude of signs to the contrary.

The Reagan administration introduced its long-threatened legislation through Sen. Pete Wilson (R, Calif.) in mid-December. The bill would prohibit states from imposing corporate income taxes on a worldwide unitary basis; limit the ability of states to tax dividends received by U.S. companies from foreign corporations; and provide states with federal assistance in gathering information necessary to administer tax laws relating to multinational firms. Even though the White House took this risky step, the unitary tax issue would not be resolved until 1986; there simply was not enough time left for states to respond in 1985.

Part VI

U.S.-Japan Trade and Direct Investment

The mid-1980s were a time of growing economic interdependence between the United States and Japan. The importance of the United States as a market for Japanese manufacturers continued to increase, with this country taking 37.2 percent of Japan's exports in 1985 compared with 24.2 percent five years before. Conversely, Japan remained the biggest and most stable overseas customer for American-made manufactured products as well as agricultural and industrial raw materials at a time when U.S. exports to many important markets were running into problems. Another sign of the expanding linkages between the two economies was the lengthening list of U.S. companies that sourced components and production equipment from Japanese suppliers for the products they turned out.

This period also marked Japan's emergence as a key supplier of capital to the United States. Its net purchases of Treasury obligations alone jumped from an estimated $6.1 billion in 1984 to $19.2 billion the following year, while total net purchases of U.S. securities by Japanese investors nearly tripled in 1985 to $29.9 billion, according to Wall Street calculations. Matching Japan's increasingly important portfolio investment role was its move into the number-three position among foreign direct investors in the United States.

The quickening pace of U.S.-Japan economic integration in the mid-1980s created frictions and fears on both sides of the Pacific. It was clear, however, that neither country could escape its increasing involvement with and dependence on the other.

Trade

Given the nature of the growing trade interdependence between this country and its biggest offshore trading partner, an increase in the U.S. trade deficit with Japan was inevitable. Already at a politically troublesome $19.3 billion (imports valued on a Customs basis) in 1983, the bilateral imbalance swelled to $33.6 billion the following year and then hit $46.2 billion in 1985. This nonstop expansion of red ink certainly played a role in the rapid deterioration of the overall U.S. trade account in the mid-1980s, but as discussed in Part II, it was just one cause of the yawning gap between aggregate purchases from abroad and total overseas sales.

U.S. Exports to Japan

After increasing during the first two years of the Japanese economic expansion, U.S. exports to Japan stumbled in 1985, falling 4 percent to $22.6 billion. While sales were expected to be off, the size of the drop was somewhat surprising since domestic demand generated more of Japan's growth in 1985 than in either of the two previous years and the dollar peaked against the yen in February 1985 after a long run-up in value. One key to the riddle was lower international commodity prices; another was stiffer competition for sales of industrial and agricultural inputs.

These developments in fact accounted for a big part of the drop in exports of intermediate goods, which fell 5 percent to $8.7 billion after rebounding 4.6 percent in 1984. They were also responsible for virtually all of the 15.7 percent contraction to $5 billion in sales of food and feed — a contraction that returned shipments to their 1982 level. At the same time, sales of capital goods, the category most affected by the performance of domestic demand and the dollar-yen relationship, did expand, increasing 5.5 percent to $5.9 billion on top of a year-earlier gain of 10 percent.

Industrial Supplies The first half of the 1980s was a difficult, frequently frustrating period for American suppliers of most big-ticket industrial raw materials and intermediate inputs — ironically enough, for reasons that had nothing to do with the strong dollar. After two years of false starts, Japanese manufacturing output finally recovered in 1983, but the rebound generated little new export business for U.S. companies since it largely bypassed the basic industries that are the major consumers of imported industrial supplies. Neither did struggling exporters get much relief the next year when the expansion spread to this part of the manufacturing sector. A number of Japanese industries producing intermediates emerged from the recession leaner and more competitive, wiping out market opportunities for their American counterparts; in other industries, raw material exporters had to contend with third-country suppliers new to the Japanese market or intensified sales competition from old rivals. Already hard-pressed, U.S. exporters were dealt another setback in 1985: growth in Japan's basic industries slowed or even reversed course.

U.S. coal suppliers certainly faced a no-win situation in 1985. For starters, Japanese steel production, which had rallied in 1984 from a four-year slide, was flat, held down both by smaller orders from all major domestic steel users except automotive makers and by reduced shipments to every important export market other than China. Putting a double damper on coking coal demand, electric furnace operators again expanded output at the expense of integrated manufacturers. But these developments were the least of American exporters' troubles.

The real problem was depressingly familiar: steel mills were overcommitted on coking coal deliveries from mines in Australia and Canada, a number of which are financed or owned in part by Japanese interests. To make room for these shipments, the mills resorted to the old standby of cutting purchases from U.S. coal companies. American producers consequently ended up supplying just 18 percent of Japan's 1985 coking coal imports — half their 1982 market share and four points below the 1984 level.

The fact that Japanese electric utilities bought more steam coal from this country did nothing to contain the U.S. industry's growing trade frustrations, which were exacerbated by the news that steel mills had increased coking coal imports from the Soviet Union and maintained deliveries from China and South Africa at 1984 volumes. In any case, the increase in steam coal shipments was too small to prevent total U.S. coal exports from dropping 11.1 percent to under $0.8 billion.

The contraction in coal shipments was an admittedly extreme example of the fallout from expanded import competition in the often sluggish Japanese market for industrial supplies, but the same script was acted out on a more modest scale for a number of other U.S. exports. Log and lumber suppliers could vouch for that. Japanese housing starts increased in 1985 for the second consecutive year, reaching their highest level since 1980, but this gain generated little extra business for sawmills, whether domestic or foreign, because of the long-term trend toward proportionately fewer wooden housing units and smaller average floor space.

But Pacific Northwest log exporters got an unexpected break. In a complete reversal of 1984's picture, Japanese wholesalers and sawmills entered the year with skimpy stocks of North American softwood logs. To keep supplies from moving any closer to the level at which domestic prices come under pressure, importers built up inventory. Restocking gave U.S. producers the chance to make up the ground they had lost in 1984 when importers ran down inventories by limiting purchases from this country.

But regaining this ground was an uphill battle since Canadian exporters were back in the market and again undercutting U.S. prices. Although the Canadian strategy yielded the same dividend as in 1984 — deeper inroads in the Japanese imported softwood log market, U.S. perseverance also paid off. American exporters recaptured their 1983 market share, largely by taking sales from the Soviet Union, the number-two supplier. In the process, U.S. sales of logs and lumber went up 5.3 percent to just short of $0.9 billion.

A temporarily resurgent domestic industry and an expanded group of international rivals gave U.S. exporters of petrochemical intermediates a double taste of competition in 1985's slower-growing or flat Japanese market for plastics, synthetic fibers, surfactants, synthetic rubber, fertilizers and other downstream products. Japanese manufacturers of ethylene, the basic building block for petrochemical intermediates, got a better handle on their high production costs in 1985, thanks to continuing declines in the price of naphtha, the industry's predominant feedstock and fuel, and the completion of a government-orchestrated capacity-reduction program.

Progress on the cost front did not erase the overall competitive edge of American suppliers of ethylene derivatives in the Japanese market, but it did limit or reduce

export opportunities for specific commodity intermediates like acrylonitrile. In other commodity product markets, including ethylene dichloride, ethylene glycol and styrene, the sales fight had an added dimension: competition from newcomer Saudi Arabia and a more aggressive Canadian industry. Here the United States generally ended up being the odd man out.

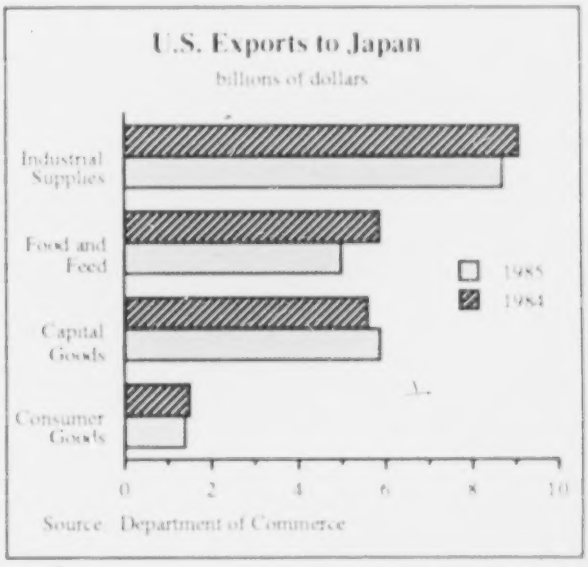
The checkered export performance of petrochemicals was duplicated by the catch-all category of industrial inorganic chemicals. In general, these are also commodity products where international competitiveness is determined by plant size and/or supply availability — both pluses for American makers; in some cases like soda ash and other chloralkalis, U.S. producers have an additional advantage over their Japanese competitors because of lower energy costs.

But soft Japanese demand in a number of the diverse end markets for commodity industrial inorganic chemicals — automotive products, housing, paper and pulp, metals and fertilizers as well as other chemical products — produced a mixed export record for U.S. companies. With flat sales of the biggest-ticket industrial inorganic chemical export — uranium and thorium compounds, which are used primarily as catalysts and reagents in medical research and diagnostic procedures, total chemical sales slipped 1.5 percent in 1985 to $1.5 billion.

While increased competition from third-country suppliers made life difficult in 1985 for U.S. exporters of a long list of industrial inputs, West Coast petroleum refiners retained their role as swing suppliers of heavy (residual) fuel oil to Japan. Moreover, they continued to profit from the problems of the Japanese industry. Slower growth plus the ongoing switchover to nuclear power and liquefied natural gas for electricity generation and to coal for industrial fuel consumption forced Japanese oil refiners to reduce output again last year. This cutback, which dropped total fuel oil production to 75 percent of its 1980 level, left the country short on heavy fuel oil for specialized uses, including bunker fuel for coastal shipping.

With U.S. consumption of gasoline and light (distillate) fuel oil up in 1985 but demand for heavy fuel oil off, California refiners had surplus stocks of residual fuel oil available for export to Japan. Larger shipments of this product as well as petroleum coke more than offset the reduced outflow of light fuel oil, boosting sales of petroleum products 11.6 percent to almost $0.8 billion.

Food and Feed While Japan proved to be a better market for U.S. agricultural commodities in 1984 than analysts and traders had expected, their generally pessimistic projections for 1985 were unfortunately on target. If anything, estimates of corn shipments erred on the high side — an understandable mistake since, on paper at least, developments in the market for livestock and poultry feed, the end use for roughly three-fourths of corn deliveries, signaled another big-volume year.



The strengthening yen on top of falling international grain and soybean prices allowed feed industry price leader Zennoh, a national federation of cooperatives controlling nearly two-fifths of Japan's feed market, to cut bulk feed prices in 1985 to their lowest levels since the late 1970s. With declines of 6 to 8 percent in the major cost of production for broiler, egg and milk producers and in the second-biggest cost for hog- and beef-finishing operations, Japanese formula feed demand remained on the upswing, shrugging off the dampening impact of weaker farm prices for pork, poultry meat and milk.

Helped paradoxically by greater output of hog rations and broiler feed, compound feed production expanded by a larger margin than forecasters had predicted, extending the string of record-breaking performances to a fourth year. Although relative feed grain prices again meant that sorghum supplied a disproportionate share of the extra volume needed to increase output, feed mills did use some more corn.

At any other time, this business would have automatically gone to American exporters, but 1985 was the year the U.S. stranglehold on Japan's feed corn market was broken. Japanese trading companies made no apologies for buying almost one-seventh of the feed industry's corn requirements from China or for purchasing a small volume of Argentine corn for mixing. Not only was Chinese corn priced below American corn on a delivered basis, but it had a higher protein content and a lower moisture level.

Although American corn suppliers needed no reminder that their luck had run out, they still got one. South Africa's normally big share of the Japanese market for corn to manufacture sweeteners, starch and other processed corn products was up for grabs again because of a second year of short supplies. But instead of taking over Japan's industrial corn market as they had in 1984, U.S. exporters were forced to share this business with their new rivals, the Chinese.

This double setback threw off predictions of 1985 U.S. corn shipments, as volume dropped one-fifth below 1984's record level. More importantly, the combination of an unexpectedly big fall in shipments and another decline in export prices spelled trouble for the bilateral trade figures: sales of the former number-one U.S. export to Japan contracted 35.1 percent to $1.3 billion.

While higher-than-projected Japanese production of commercially mixed feed was of no help to struggling American corn suppliers, it did get U.S. soybean exports back on track sooner than analysts and exporters alike had anticipated. Their initial pessimism was well-founded, however. Despite a reduction in the 1984 soybean crush, Japanese oilseed processors were still saddled with unusually high soybean meal stocks at the beginning of 1985, in large part because 1984 relative protein meal prices had dictated greater use of fish meal and, to a lesser extent, rapeseed meal in compound feed. Moreover, the prospects for working stocks down in 1985 to a level that would support expanded crushing and larger soybean imports seemed bleak no matter how attractively soybeans were priced, given the limited gain predicted for feed production and rising demand for rapeseed oil, particularly in salad dressings.

Much to the relief of U.S. soybean exporters, 1985's sizable increase in formula feed output allowed Japanese oilseed processors to reduce meal inventories ahead of schedule. So did a partial flip in the relative prices of feed ingredients that gave vegetable protein meal an edge on other non-grain inputs, although contrary to preliminary indications, rapeseed meal was priced better than soybean meal over the six months starting in April.

With stocks back to manageable levels, processors stepped up soybean crushing and at the same time contracted for more imports. While this turnaround rescued U.S. shipments from back-to-back declines, there was a down side for American suppliers: their monopoly on providing all the soybeans crushed by the Japanese industry was broken by Brazil, which received orders for roughly half of the extra volume purchased in 1985. Still, the additional contracts coming to this country helped stop the decline in U.S. sales caused by falling export prices at the $0.9 billion-plus mark, a 20 percent drop.

Capital Goods A second year of double-digit growth in business spending on plant and equipment not only was the key to Japan's continued domestic economic expansion, but it also made capital goods the one consistent bright spot in an otherwise gloomy 1985 export picture. Paced by big corporations in the electronics, chemicals and automotive industries, the spending boom extended across the full range of investment objectives — modernization, including automation, capacity expansion, diversification, and the development of new product and process technologies. For most U.S. makers of capital goods, though, bigger Japanese expenditures on modernization/automation remained the ticket to larger export sales.

The expanding market in Japan for factory and office automation equipment certainly provided additional sales opportunities for American manufacturers of computer systems and peripheral equipment if 1985's 14.1 percent jump in exports to $1.3 billion was any guide. What made this gain twice as significant was that it came close to the estimated growth of the Japanese computer market, indicating that American competitors successfully defended their eroded market position — pegged in 1985 at about 30 percent overall and roughly 40 percent in mainframes — from further encroachment by their Japanese challengers.

Most U.S. companies, whether newcomers to Japan or seasoned market veterans, continued to rely exclusively on exports of domestically assembled products to supply Japanese customers. But following the path blazed by International Business Machines Corp., a small but rising number of systems makers were opting in the mid-1980s for a different strategy: manufacturing part of their line in Japan and filling it out with exports from the United States. This approach, which boosted shipments of parts (including subassemblies) to almost $0.6 billion in 1985, seemed to be paying extra dividends.

To cite the most obvious example, IBM Japan Ltd.'s 1985 domestic sales climbed 20.7 percent to ¥658.6 billion, led by brisk shipments of the newly introduced 3090 (Sierra) series of large mainframes, Systems 36 and 38 minicomputers and the 5550 workstation family, the Japanese-language version of the IBM PC. In comparison, Japanese industry leader Fujitsu, Ltd. increased sales at home by roughly 20.8 percent to an estimated ¥845.7 billion in the year ending in March 1986.

While exports of measuring and testing equipment and medical apparatus also expanded again in 1985, a number of 1984's star sales performers faltered, including semiconductor production and assembly equipment and integrated circuits. What kept capital goods firmly entrenched in the plus column was a rebound in shipments of commercial aircraft, which soared 67.3 percent to $0.9 billion.

Continuing to expand and modernize, Japan Air Lines added the 50th Boeing Co. 747 to its fleet, this one a 747-300 for international service, while taking delivery of its first three 767-200s, JAL's replacement for the DC-8 made by McDonnell Douglas Corp. For its part, All Nippon Airways, Japan's major domestic carrier, put eight more 767-200s into operation, bringing its 767 fleet to 21. The number-three Japanese carrier, Toa Domestic Airlines, also upgraded its fleet, introducing two McDonnell Douglas MD-80s. Rounding out the list of 1985 aircraft deliveries to Japan, Nippon Cargo Airlines, the country's first all-cargo carrier, added its second and third 747 freighters.

Consumer Goods The sluggish growth of Japanese consumer spending finally caught up with U.S. exports in 1985, cutting sales of consumer durables and nondurables 4.1 percent to $1.4 billion. But hidden behind this figure was some positive news: sales of pharmaceuticals edged up 3.3 percent to $0.6 billion. Coming in the face of a third straight year of flat Japanese drug production and demand, this gain was further proof of the new aggressiveness of big U.S. drug companies in Japan. No longer content to just license their products to Japanese competitors, one after another American multinational was moving toward broad-based local production, usually centered on antibiotics, the biggest-selling drugs in Japan, as well as to direct distribution of its products.

U.S. Imports from Japan

Imports from Japan, which seemed to be on a runaway course in 1984, were reined in during 1985 by the U.S. economy's paltry 2.7 percent inflation-adjusted growth. True, purchases climbed 20.4 percent to $68.8 billion on a Customs value basis, but this increase, however politically explosive, was still only half of 1984's. The big difference was the pace of capital spending. A driving force in the first two years of the domestic economic expansion, business investment in plant and equipment slowed to a crawl in 1985. This capped deliveries of Japanese-made capital goods at $21.5 billion for an 11.5 percent gain — a far cry from 1984's 62.2 percent surge. Moreover, with American industry operating well below capacity for much of the year, arrivals of intermediate goods went up just 2.7 percent to $7 billion after jumping 35 percent in the previous 12 months. At the same time, though, the surprising durability of consumer spending meant another high-growth year for imported consumer goods, with purchases expanding 24.4 percent to $14 billion on top of a 35.8 percent spurt in 1984. It also helped transform automotive products from 1984's import laggards (a 23.9 percent gain) to 1985's pacesetters as purchases jumped 32.1 percent to $25 billion.

Automotive Products Measured by Detroit's traditional yardstick, 1985 was a banner year for American automotive manufacturers. Combined U.S. car and truck sales climbed 8.6 percent to 15,723,116 units, erasing the old record set in 1978 by a solid 316,011 vehicles. Total car sales topped the 11 million mark for the first time since 1978 and were the fourth highest on the books at 11,043,768 units. The clincher was the industry's balance sheet. Profits at General Motors Corp., Ford Motor Co., Chrysler Corp. and American Motors Corp. added up to a staggering $8.3 billion, second only to 1984's $9.8 billion bottom line.

But these numbers did not tell the full story of Detroit's performance in the 1985 car market. Sales of domestic makes were only up 3.2 percent to 8,204,542 units, a mere shadow of the 17 percent gain posted in 1984. Worse, more than one-third of the quarter-of-a-million additional cars sold during the year were assembled by Honda of America Manufacturing Inc. or the two newest U.S. auto companies — Nissan Motor Manufacturing Corp. U.S.A. and New United Motor Manufacturing Inc., the Toyota Motor Corp.-GM venture. In a double blow, the Big Three had to resort to cut-rate financing and other incentives time and again to keep sales on the upswing, while import dealers in major metropolitan areas were able to tack hefty markups on the top-selling Japanese models.

Frustration was an occupational hazard for auto industry executives regardless of nationality in 1985. In mapping out U.S. sales strategies for the April 1985-March 1986 period, Japanese car manufacturers proceeded under the assumption that the export controls that had played havoc with their American marketing plans for the previous four years would be lifted. At the eleventh hour, however, a wavering Tokyo opted to extend the restraints for a fifth year but to raise the export limit on sedans and hatchbacks from 1,850,000 units to 2,300,000, with comparable 24 percent-plus increases in the separate quotas on shipments of four-wheel-drive cars, station wagons and vans (to 113,000 units) and vehicles for sale in Puerto Rico (to 95,700 units).

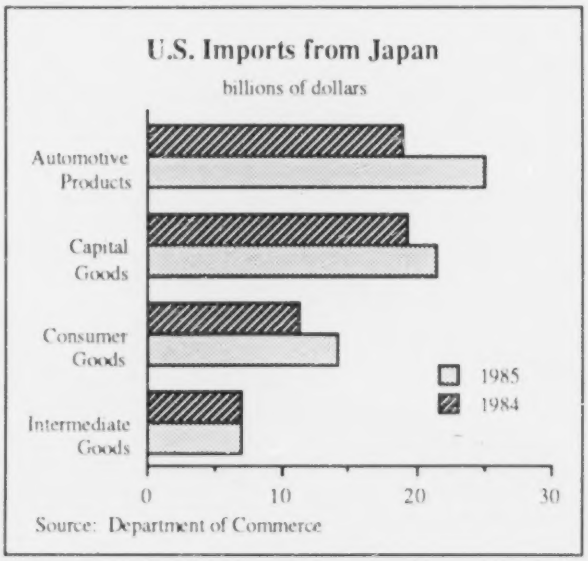
Tokyo's attempt to navigate a middle course backfired on both sides of the Pacific. The hike in the shipment ceiling for the 12 months starting in April 1985 boosted U.S. calendar year purchases of Japanese-made cars 29.6 percent to 2,527,467 units valued at $16.2 billion, a politically damaging 31.4 percent bulge in the import tally. Adding fuel to the smouldering protectionist fires, sales of made-in-Japan cars, which had dipped in 1984, jumped 16.4 percent to a record 2,217,860 units and supplied 20.1 percent of the American market. Japanese government and industry spokesmen were quick to point out that this market penetration was still below 1980-83 levels, but all congressional supporters of U.S. auto industry protection saw was that Japanese exporters had added 1.8 points to their artificially depressed 1984 share.

While the Japanese government was trying to contain the fallout in the United States from its decision to raise the restraint level, it also had to contend with grumblings at home about how the extra sedan/hatchback quota was allocated. Roughly three-fifths of the 450,000-unit increase was earmarked for shipment by Japan's five smaller exporters, with the lion's share going to GM's two affiliates — Isuzu Motors, Ltd. and Suzuki Motor Co., Ltd. — and to Mitsubishi Motors Corp., which supplies Chrysler. This formula left some 185,000 cars for distribution among Toyota, Nissan Motor Co., Ltd. and Honda Motor Co., Ltd. — enough to build skimpy U.S. inventories to levels that supported expanded sales in 1985 but not as many cars as corporate planners for the three import leaders projected their companies could sell.

Still hamstrung in their ability to supply U.S. demand, Japanese car makers continued the profitable move into the midsize and luxury markets that are Detroit's mainstay. For Toyota this marketing strategy meant that the top-of-the-line Cressida and Camry models generated 28 percent of 1985 sales, which came to 620,047 cars, compared with 23 percent of the year-earlier total of 557,981 units. Including the upscale Celica, Supra and new MR2 sports car as well, fully one-half of the cars sold by the number-one importer in 1985 fell into the midsize or luxury segments. Nissan used the same tactics in expanding sales 10.3 percent to 535,372 cars, with the high-end Maxima, 300 ZX and 200 SX accounting for 43.4 percent of this number. Honda's 1985 import sales of 406,413 units (up 8.4 percent) were split almost evenly between small cars and upscale models, but with access to nearly 150,000 Ohio-built Accords, it had a far more profitable product mix than either Toyota or Nissan.

Big margins on their 1985 car sales allowed Japan's motor vehicle makers to continue the expensive battle for position in the fast-expanding but fiercely competitive American small truck market. Sales of compact pickups, vans and sports-utility vehicles skyrocketed after 1981, jumping 30.4 percent in 1985 alone to 2,244,032 units. The increasing number of new vehicle buyers unwilling or unable to foot the $11,000-plus average cost of American cars or the equally stiff cost of Japanese models was one reason small truck sales broke records in 1985 for the fourth straight year. But a big part of the credit went to Detroit for astute product development.

After conceding a growing share of light-duty truck sales to Japanese-made compact pickups in the late 1970s, GM, Ford and Chrysler jumped into the small truck market in late 1981-early 1982 with their own compact pickup models. The immediate success of these trucks, which had larger passenger and cargo compartments and better fuel economy than the imports but were competitively priced, encouraged GM, Ford and AMC to design a new lineup of downsized sports-utility vehicles. These vehicles, unveiled in 1982 and 1983, also won almost instant market acceptance. If initial sales figures were any indication, though, the minivans introduced by Chrysler in late 1983 and GM and Ford over the next two years could turn out to be Detroit's best-selling small truck products yet.



Japanese small truck suppliers pursued some familiar marketing strategies in the 1985 phase of their four-year sales battle with American manufacturers. Aggressive pricing remained the key weapon, as importers not only kept stickers on their price-leader pickup trucks below $6,000 for the fourth consecutive year but also held the pricing line on many of their more expensive models. Moreover, they continued to add new models to their lineups, devote a disproportionate share of automotive advertising budgets to trucks, and periodically offer low-cost financing and other sales incentives.

These tactics paid off in 1985's strong U.S. small truck market. Combined sales of Japanese nameplates, which had soared 54.7 percent the year before, climbed an additional 24.4 percent to 808,529 units (including roughly 100,000 assembled by Nissan in Tennessee). In the process, imports ballooned 42 percent to 803,965 vehicles valued at $3.4 billion, a 45.1 percent gain. But these numbers were no match for the U.S. industry's results. American producers boosted sales of their innovative small trucks 34 percent to 1,435,503 units and trimmed the market share controlled by Japanese makes another 1.8 points to 36 percent.

Higher sales of American-built cars and trucks in 1985 gave another shot in the arm to beleaguered domestic suppliers of original equipment parts, but their problems were by no means behind them. For starters, U.S. car and

truck production, while up for the third straight year, still fell almost 1.2 million units short of 1978's record 12.8 million vehicles. Moreover, American producers of production components continued to lose business at the margin to foreign rivals as Detroit's drive to improve the competitiveness of U.S.-made products resulted in more contract awards for overseas suppliers.

Increased outsourcing of original equipment parts by the U.S. Big Three from both affiliates and unrelated manufacturers in Japan was one reason imports of Japanese-made automotive parts expanded 22 percent in 1985 to $4.2 billion. But greater purchases of engines, transmissions, starter motors, alternators, clutches and other products on the long list of production parts Detroit buys from Japan again took a backseat in the import expansion to bigger deliveries of replacement parts for Japanese cars and trucks.

The roughly 19.2 million Japanese vehicles sold in this country between 1978 and 1985 created an enormous market for replacement parts. Although hard numbers were missing, it was commonly thought that these sales were split about evenly between franchised new car and truck dealerships and other automotive sales and service outlets like repair shops and mass merchandisers. Japanese suppliers have a near monopoly on the parts requirements of dealers' service organizations, particularly major mechanical components. They have also made deep inroads in the other half of the aftermarket, which is the biggest sales channel for batteries, tires, spark plugs, filters, mufflers, brake parts and other high turnover parts.

On top of the import pull of the huge aftermarket for Japanese cars and trucks, the domestic assembly operations of Japanese automotive manufacturers were starting to inflate parts purchases in the mid-1980s. At the start of the decade none of Japan's nine major motor vehicle companies had a U.S. production facility. In 1985, however, Honda built 145,337 Accords at its Ohio plant, Nissan turned out 107,442 small pickups and 43,810 Sentra subcompacts in Tennessee, and NUMMI assembled 64,601 Toyota-designed subcompacts for sale under the Chevrolet name in its first full year of operation. With all three companies sourcing their engines, transmissions and differentials or transaxles as well as other key production components from Japan, the import numbers had to go up.

Capital Goods After hiking capital spending by an awesome 25 percent over the 1983-84 period, U.S. business took a breather in 1985. Nowhere was this pause more evident than in the computer market as sputtering growth replaced the breakneck expansion of the early 1980s. The market's high-fliers, personal computers, came back to earth, posting gains that outsiders would tag as robust but suppliers considered moderate, while minicomputer sales were lackluster and mainframe shipments disappointing. Few computer companies, American or foreign, were immune to the market's scaled-back performance, but judging by the import statistics, the ripple effect on Japanese vendors was surprisingly big.

Purchases of Japanese-made computers, peripherals and parts were up just 1.5 percent to $3.2 billion — a far cry from 1984's 78.9 percent spurt and the 115 percent surge of the previous year. Although no product breakdown was available, indirect evidence suggested Japanese manufacturers had a rough time across-the-board. At best, the group of companies that dominates U.S. sales of dot matrix and daisywheel printers for use with personal computers maintained shipments at 1984's level in the flat American printer market, but financial results were unquestionably hurt by another round of price-cutting. The story was much the same for Japanese floppy disk drive vendors, which control the big domestic market for 5.25-inch drives and the smaller one for microfloppies: revenues fell in 1985's no-growth environment as a price war compounded a shipment drop. Business held up better for 5.25-inch rigid drives, but this did not translate into much of an import gain since Japanese competitors are the U.S. market's secondary players.

As weak as business might have been for Japanese makers of peripherals, they at least were able to keep shipments in the neighborhood of 1984 numbers. The same could not be said for the handful of companies producing business-oriented personal computers for sale here. Having failed to dent the market the first time around with systems that were incompatible with the IBM PC, Japanese computer manufacturers discovered in 1985 that climbing on the IBM PC bandwagon did not guarantee success either — particularly in a rough-and-tumble market like that year's.

The scaled-back pace of U.S. capital spending last year also trimmed growth in the telephone terminal equipment market, but this damper did not explain why imports of Japanese-made private branch exchanges, key systems and single-line telephones leveled off at $0.7 million. Part of the answer dated back to 1984, when purchases more than doubled and contributed to a glut that had still not been eliminated by the end of 1985. A resurgent American Telephone & Telegraph Co. also made life difficult for Japanese manufacturers of PBXs and key systems by halting the erosion of its huge customer base with popular product offerings and system enhancements. Paradoxically, the only market segment where Japanese suppliers made headway in 1985 was the one in which they were thought to be at a competitive disadvantage — telephones. But here Japanese makers simply filled the expanding niche for expensive feature-laden phones.

When sales of personal computers started to slow in 1984's second half and purchases of mainframes and

minicomputers followed suit, the boom-and-bust U.S. semiconductor industry knew it was in trouble since computer makers had been generating anywhere up to half of its booming business. How much trouble soon became apparent as orders from merchant manufacturers' other major customers — industrial and consumer electronics products, telecommunications equipment and military hardware — weakened. But anemic demand turned out to be only the beginning of the industry's 1985 woes. With American makers and Japanese rivals scrambling for business to keep a huge amount of new capacity in operation, prices — particularly for 64K dynamic random access memories, 256K chips and other high-volume memory products — went into a tailspin.

The price war took a heavy toll on bottom lines in the U.S. merchant semiconductor industry. It also thinned the already reduced ranks of domestic companies making the workhorse 64K DRAM. For other producers the latest bout of cutthroat DRAM pricing was the final straw: they abandoned this end of the business altogether. But Japan's big semiconductor manufacturers were pinched as well. Admittedly, their problems were not as severe, yet a 34.6 percent cutback in U.S. purchases of Japanese-made semiconductors to $1.2 billion, on top of weak demand at home, did make for bumpy going. Moreover, after adding several points to their U.S. market share in 1984, Japanese suppliers apparently hit a roadblock in 1985.

While semiconductor producers were bearing the brunt of the slower pace of capital spending, U.S. machine tool builders continued to benefit from the orders placed in 1984 and 1985's first half by automotive manufacturers, defense contractors and other durable goods makers investing in plant modernization or expansion. These bookings lifted shipments by nearly one-fourth in 1984 and another one-tenth the next year, but industry revenues still fell far short of their 1980-82 levels. The wait-and-see investment attitude of corporate planners in a number of important end-user industries was one cause of this gap. Equally important, American capital goods manufacturers bought more Japanese-made metal cutting and metal forming equipment, boosting imports 25.7 percent to just under $1 billion and raising Japan's share of U.S. apparent consumption to 21.6 percent, a 0.9 point gain. For products like small and medium-sized numerically controlled lathes and machining centers, purchasing managers had little choice since leading domestic machine tool builders had conceded commodity market segments like these to their Japanese competitors as part of a massive restructuring drive.

Consumer Goods The surprising strength of consumer spending in 1985, the third year of the U.S. economic expansion, translated into another record-breaking sales year for consumer electronics products. Color televisions remained the best sellers, both in volume and sales dollars, but video cassette recorders ran a close second on both counts. Falling prices continued to whet VCR demand, particularly in the market's low end, where discount prices on established brands broke through the $250 barrier. At the same time, the introduction of camcorders (portable one-piece camera-recorder combinations) boosted sales at the high end. Technology enhancements that made VCRs easier to use, more versatile and smaller also promoted the popularity of the machines. So did the continuing spread of neighborhood video stores with their constantly expanding libraries of prerecorded programming.

For Japanese consumer electronics manufacturers, which supplied almost all the VCRs sold here despite the arrival of Korean competitors, there was only one problem with 1985's upbeat picture: thin profit margins. As fast as retailers were moving VCRs out of stores (sales to dealers shot up from 7.6 million units in 1984 to almost 11.8 million in 1985), imports were expanding even faster, jumping from 9.3 million units to nearly 15.8 million worth $4.1 billion. This surge set the stage for another price war and, market watchers predicted, an industry shakeout.

Intermediate Goods With a cross-section of U.S. industry muddling along in 1985, few Japanese suppliers of intermediate goods posted good sales results. For Japanese steel makers, though, another factor was at work: limits on their U.S.-bound shipments. These restraints, negotiated in mid-March but retroactive to October 1, 1984, cut import volume 9.7 percent to 5,990,077 tons worth $3 billion-plus. They also trimmed Japan's share of apparent consumption to 6.2 percent from 1984's 6.7 percent level.

Higher output in the U.S. automotive industry — steel's single largest customer — and increasing production of appliances propped up shipments of domestically produced cold-rolled, hot-rolled and coated sheets but had no spillover effect on Japanese-made products. Similarly, mills in Japan were unable to capitalize on the strong demand for flat-rolled products as well as structural shapes and wire rods created by booming construction activity. They also did not benefit from the strength in the market for oil-country tubular products, although shipments of Japanese-made large diameter line pipe did expand. In fact, line pipe and standard and mechanical tubing were the only major steel products that increased in volume in 1985.

Direct Investment

United States in Japan

Perhaps the most overlooked sign of the expanding integration of the American and Japanese economies in the mid-1980s was the pickup of U.S. direct investment activity

in Japan. This pickup, which was masked in large part by the sluggish growth of American equity investment in most other areas of the world, lifted the U.S. stake in Japan from 1982's $6.4 billion closing figure to $9.1 billion at the end of 1985. In that year alone corporate investors increased their Japanese holdings by a net total of $1.2 billion — 14.8 percent more than 1983's net addition (which was depressed by the repatriation of the proceeds from the sale of Texaco Inc.'s 50 percent interest in Mitsubishi Oil Co., Ltd.) and just shy of the $1.3 billion net gain registered in 1983.

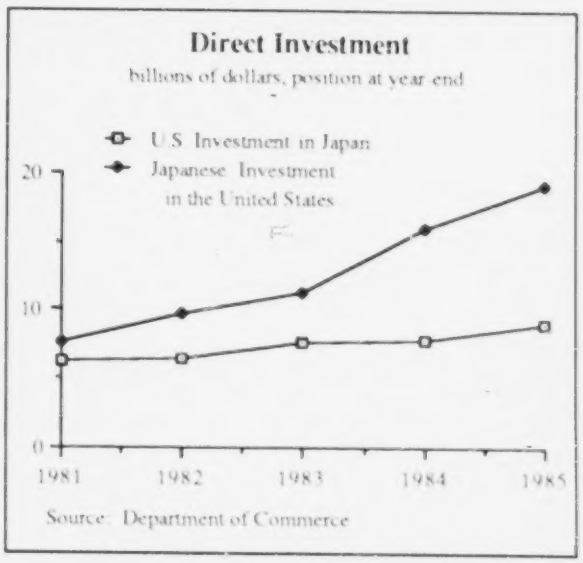
In a repeat of the two previous years, the major source of U.S. investment financing in Japan in 1985 was reinvested earnings. The higher cost of raising capital in the United States partly explained this funding pattern, as did parent companies' still huge requirements for money to underwrite their domestic operations. But the main reason American businesses relied so heavily on reinvested earnings was because their Japanese investments were big income producers in the mid-1980s. In 1985, for example, the average rate of return on U.S. investment in Japan was an incredible 18.7 percent.

Japan's manufacturing sector remained the center of U.S. direct investment activity in 1985 as companies earmarked a net total of $0.7 billion for the construction or expansion of production and assembly facilities. This time around over half of the money went into factories to manufacture nonelectric machinery products, with most of the rest divided between the transportation equipment industry and the "other industry" category, which includes scientific, measuring and medical instruments. American firms also continued to beef up their sales operations in Japan and to put more money into the Japanese petroleum industry. What set 1985 apart from earlier years, though, was the relatively large investment U.S. businesses made in Japan's finance and insurance sector.

Japan in the United States

Japan's fast-expanding direct investment presence in the United States received a considerable amount of publicity in the mid-1980s, but this attention did not necessarily eliminate misconceptions about the size of the Japanese stake in corporate America, the sectors that had attracted the most money and how Japanese companies financed their U.S. investments. To start with, Japan's direct investment position in this country doubled between 1982 and 1985 to $19.1 billion at year-end. Boosted by net additions of $4.7 billion in 1984 and $3.1 billion the next year, this total gave Japan a lock on the number-three foreign investor slot, but it still trailed far behind the United Kingdom ($43.8 billion) and the Netherlands ($36.1 billion).

Although Japanese investment in the United States took off in the mid-1980s, one thing remained the same:



corporate investors continued to give top priority to the financial health of their American distribution units. In both 1984 and 1985, for example, Japanese businesses invested a net total of $1.9 billion in the wholesale trade sector, bringing their holdings up to $11.6 billion at the end of the period. Japanese investment in the manufacturing sector, the subject of constant media attention, ranked a distant second at $2.6 billion, barely ahead of the $2.2 billion total invested in the banking industry. In fact, financial institutions spent almost as much to expand their U.S. operations over the 1984-85 period ($0.8 billion) as manufacturers put into new plant construction, acquisitions and increased capacity at existing facilities ($1 billion).

Investing in the United States proved to be a profitable undertaking for Japanese companies. In 1984 their equity holdings generated $1.9 billion in income. This worked out to an average rate of return of 13.8 percent — more than double the figure for all foreign direct investment in the United States. With the economy's slowdown in 1985, income dropped to $1.7 billion. The average return on investment was therefore cut to 9.7 percent, but this yield was still twice as high as what foreign investors as a group earned.

Roughly 80 percent of the money Japanese businesses made on their U.S. investments in the mid-1980s was produced by wholesale trade subsidiaries. Banking affiliates also operated in the black, but Japanese-owned production and assembly units had not yet turned the corner on profitability. With parent companies plowing close to 90 percent of the annual pre-tax profits of their U.S. wholesale trade organizations back into operations in this country and banking investors following a similar strategy, reinvested earnings financed nearly one-third of the growth in Japan's

direct U.S. investment position in the 1984-85 period. Equity capital inflows underwrote another one-third-plus of the expansion, while an increase in intercompany debt covered the remainder.

Update of JEI Manufacturing Survey

The drumbeat of criticism by Washington about the trade practices of Japanese corporations in the mid-1980s drowned out some good economic news about the same companies from state capitals across the country: more and more Japanese businesses were making the products they sell here in U.S. plants. In 1985 alone 70 names were added to the list of American manufacturing companies owned wholly or in part by Japanese corporate investors. This expansion, by far the biggest one-year addition in the relatively brief history of Japanese investment, lifted the year-end total of Japanese-affiliated manufacturers in the United States to 435, including 30 companies in which businesses headquartered in Japan had minority interests. More importantly, Japan's expanding U.S. manufacturing presence meant jobs — close to 100,000 of them in industries ranging from metals and motor vehicles to communications and computer equipment, integrated circuits, consumer electronics and food products.

1985 Investments Japanese investment in U.S. production facilities developed a momentum of its own in the mid-1980s. This conclusion might seem premature since Japanese corporations only became active investors in this country's manufacturing sector halfway through the 1970s. But no other explanation fit the bill, especially given the investment climate in 1985. At that time just as many of the factors Japanese executives weigh in considering assembly or manufacturing operations in the United States indicated wait rather than invest.

The bumpy slowdown in the U.S. economic expansion in 1985 weakened the pull of what was perhaps the single largest cause of 1984's then-record level of Japanese investment activity — the strength and seeming durability of the recovery here. Similarly, the weakness of the yen until late September curtailed the push that had propelled Japanese corporations to invest in the United States during the first half of 1984 since it both upped the price of building new plants or acquiring existing ones and reduced the cost of supplying the American market through exports.

At first glance, the double-digit hike in Japanese capital spending for the second straight year provided grounds to assume that Japanese companies would step up their manufacturing investments in this country. This reasoning was debatable, however, if only because the increasing pace of deregulation at home opened up new investment opportunities there for Japanese businesses. Neither could the fresh outbreak of protectionist rhetoric in Washington be assigned the decisive role that some ascribed to it. Whatever the political pressures, Japanese firms will not put money into American production facilities unless they are convinced that these investments are economically sound.

Against this backdrop the results of the Japan Economic Institute's sixth annual survey of Japanese investment activity in the U.S. manufacturing sector were something of a surprise. A record-breaking 64 Japanese majority-owned companies joined the ranks of domestic assembly or manufacturing concerns during 1985, 23 more than the year before and almost three times greater than 1982's recession-curbed total. Equally eye-catching, eight firms already turning out products in the United States started work on new factories or acquired additional plants, while a long list of other producers invested in capacity expansion at their existing facilities. Moreover, Japanese corporations, which had shied away from minority investments in American production firms in both 1982 and 1983, obtained shares of at least 10 percent but less than 50 percent in six businesses in 1985, although this was two less than in 1984.

New plant construction remained the preferred investment route, outnumbering acquisitions by a two-to-one margin. This was the same ratio that had prevailed in the period through 1980 and again in 1983, but in the intervening years the investment mix first tilted toward an even split (1981 and 1982) and then swung in the opposite direction, hitting a four-to-one breakdown in 1984.

Like their predecessors, 1985's newcomers, especially the fast-increasing number of small and medium-sized companies, almost uniformly decided to start from the ground up, in large part because their initial U.S. operations were limited to final assembly work. But even big Japanese corporations that were established producers in this country — companies like Canon Inc., Fujitsu, Hitachi, Ltd., Pioneer Electronic Corp. and Toshiba Corp., as well as C. Itoh & Co., Ltd. and Mitsubishi Corp. — went the new investment route.

While Japanese corporate investors were by no means on the same acquisition binge in 1985 as their American counterparts, they did take over a record 21 U.S. manufacturing companies. The vast majority of these acquisitions were routine business transactions. But one — the purchase of New Hampshire Ball Bearings Inc., an important supplier of bearings for defense production, by Minebea Co., Ltd., itself a leading maker of precision bearings — reignited the controversy in Washington about foreign firms controlling American companies that do work considered vital to U.S. national security interests.

Whether newcomers or repeat investors, Japanese companies continued to opt in most cases for wholly owned production units rather than joint manufacturing ventures

with American businesses. Yet the mutual benefits that can be derived from production tie-ups — access to first-hand knowledge of the U.S. market for Japanese firms and help with product and/or process technology for American competitors — were making joint ventures a more frequent occurrence in the mid-1980s. In 1985, for example, 14 of the majority-owned companies established by Japanese investors were partnerships. Most involved firms unknown outside their industry, but a few paired companies with familiar names, like Mitsubishi Motors and Chrysler or Toshiba and Westinghouse Electric Corp. Japanese corporations also teamed up with American companies in another six businesses by buying a majority interest.

Year-End Count At the end of 1985 Japanese corporate investors had a stake of 50 percent or more in 405 U.S. assembly or manufacturing companies, including 32 scheduled to go onstream in 1986 or in 1987. While small and medium-scale operations were the rule, an increasing number of firms qualified as big businesses, whether measured by sales, investment, employment or all three indicators. Ironically perhaps, the two biggest were joint ventures: National Steel Corp., which is half owned by Nippon Kokan K.K., and Alumax Inc., a partnership of Mitsui & Co., Ltd., Nippon Steel Corp. and AMAX Inc. This country's sixth-largest integrated steel producer with 1985 sales of $2.1 billion, National Steel employed 12,000 people at its three Midwestern mills. The sales ($1.9 billion) and employment (12,000) numbers for Alumax, one of the top three U.S. producers of primary aluminum and a leading maker of fabricated aluminum products, closely matched the National Steel figures, but the company's workforce was scattered among 89 facilities in 29 states.

Other big ventures included the three Japanese automotive assembly plants currently in the United States. At the end of 1985 Honda of America Manufacturing was gearing up for production of 150,000 subcompact cars a year at its Ohio plant in addition to the roughly 150,000 compacts it was turning out. This expansion was expected to add several hundred workers to the 2,300 already employed. Nissan Motor Manufacturing was also increasing output at its Tennessee factory, moving toward full-capacity production of 240,000 small pickup trucks and subcompact cars a year by the end of 1986 with 3,100 employees. For its part, New United Motor Manufacturing, the California-based Toyota-GM joint venture, reached full operation in 1985, assembling 200,000 cars annually with a workforce of 2,500 for sale through Chevrolet dealers.

Some of the consumer electronics companies also numbered among the largest Japanese manufacturing operations in this country. Sony Manufacturing Corp. of America employed 1,600 at its San Diego, California color television plant, while the Alabama cassette tape factory operated by Sony Magnetic Products Inc. had 1,300 workers. Two manufacturers of color televisions and microwave ovens — Sanyo Manufacturing Corp. and Matsushita Industrial Co. — were big concerns as well, with Arkansas-based Sanyo employing 1,800 and Matsushita 1,500 at its facility in the Chicago, Illinois suburbs. Rounding out the list of major investments were Kyocera International, Inc., which had 1,800 employees at three plants in San Diego, California that make ceramic packages for integrated circuits and electronic components, and newcomer New Hampshire Ball Bearings, which had over 1,900 people on its five-plant New Hampshire payroll.

The 405 U.S. assembly or manufacturing companies in which Japanese investors owned a majority stake at year-end 1985 had 583 plants in operation or under construction at that time. California was home to 153 plants, but it lost some ground in 1985 in the stiff state competition for Japanese investment, adding just five, primarily small, new facilities plus six acquired ones. Five additional plants that boosted its total to 37 helped Georgia take the runner-up title away from Texas, which dropped to third place with 36 factories. New Jersey, the location of 31 plants, held on to the number-four position as four plants were built or acquired in the state. The same number of additions gave Illinois fifth place with 26 facilities. Michigan and Ohio moved up two slots as seven more plants in each state lifted their totals to Washington state's 23. There was also a three-way tie for seventh place — 20 factories — among New York, North Carolina and Pennsylvania. Trailing this trio were Tennessee (15) and Indiana (13), with Alaska, the site of 12 operations, occupying the tenth position.

While company and plant numbers give some idea of the magnitude of Japan's corporate stake in the U.S. manufacturing sector, employment figures are a more revealing indicator. The 373 majority-owned manufacturing concerns in operation at the end of 1985 had close to 100,000 people on their payrolls. Another 10,800 or so jobs were expected to be generated when plants then under construction went onstream, including 3,500 alone at Mazda Motor Manufacturing (USA) Corp.'s suburban Detroit, Michigan plant and 2,500 at the Bloomington-Normal, Illinois facility of Diamond-Star Motors Corp., the Mitsubishi Motors-Chrysler venture. Several thousand other jobs would open up as established manufacturers completed their expansion programs. With Japanese investors also creating or maintaining jobs by taking minority positions in 30 U.S. manufacturing companies, it was safe to assume that by the late 1980s 120,000 Americans would owe their jobs to Japanese-affiliated manufacturers in this country.

Appendix A

Chronology

January 1984

10-17 With the elections for the lower house of the Diet over and the Nakasone cabinet reshuffled, Washington revives its campaign to force Tokyo to open its markets wider to American products and services. One after another, Under Secretary of Commerce for International Trade Lionel Olmer, U.S. Ambassador to Japan Mike Mansfield, high-level National Security Council and State Department representatives and Deputy U.S. Trade Representative Michael Smith press Tokyo for rapid progress on outstanding bilateral economic issues.

10 Faced with renewed U.S. demands for greater access to Japan's markets, Prime Minister Nakasone appoints a special Liberal Democratic Party commission to prepare another package of market access initiatives. By the end of April, the commission is to work out a list of concessions Tokyo can make in the areas of financial market liberalization, procurement by Nippon Telegraph and Telephone Public Corp. and trade in agricultural commodities subject to import quotas.

19 Reiterating the message delivered to Tokyo earlier in the month by high-level Reagan administration officials, Vice President George Bush calls for quick Japanese action on the fast-expanding list of problem areas in the U.S.-Japan economic relationship.

19 The Economic Planning Agency projects Japan's inflation-adjusted economic growth in FY 1984 at 4.1 percent, the first time in five years growth is expected to top 4 percent. Expanded domestic demand will make up 3.6 percentage points of the overall rise, the agency forecasts. Private organizations are generally more bullish about the economy's prospects.

20-21 Japan and the United States hold talks in Tokyo on a new agreement expanding Japan's beef and citrus import quotas. Although both sides table more flexible proposals than were presented at the last round of bargaining in October 1983, the negotiations end without a compromise, leaving just two months to hammer out a pact to replace the one concluded in late 1978.

24 Bucking other domestic steel producers as well as Reagan administration trade policymakers, Bethlehem Steel Corp. and the United Steelworkers of America file a complaint with the International Trade Commission under Section 201 of the 1974 Trade Act, asking that steel imports be limited to 15 percent of the U.S. market for five years. Opponents argue that the escape clause petition could cause the European Community to end its 1982 agreement to limit U.S.-bound shipments of most carbon steel products for three years and tempt Japan to abandon its informal shipment curbs. Bethlehem spokesmen counter that the 201 route is the fastest way to contain expanding imports from Third World suppliers.

25 The Japanese cabinet adopts an austere budget for FY 1984, limiting the growth in general account spending to a low 0.5 percent, the smallest increase in 29 years. Discretionary spending is cut across the board with a few notable exceptions, including defense and foreign aid; however, debt payments, the single largest expenditure, are scheduled to go up 12 percent.

26-27 Foreign Minister Shintaro Abe confers in Washington with top Reagan administration officials on outstanding bilateral trade issues, but the talks yield few concrete results. Mr. Abe and USTR William Brock agree to seek a political settlement to the dispute over Japan's beef and citrus quotas. At meetings with President Ronald Reagan and Vice President Bush, Mr. Abe says that an agreement will be reached by the end of March.

30 Foreign Minister Abe and USTR Brock sign an agreement extending for another three years the accord on equipment purchases by NTT. The pact revises a number of NTT procurement procedures that U.S. firms claim keep them from submitting bids or winning contract awards and incorporates a number of changes the monopoly adopted on its own.

February 1984

8 A Japan Federation of Economic Organizations (Keidanren) delegation arrives in Washington to lobby against the unitary tax system maintained by 13 states. Officials call the system the biggest obstacle to continued Japanese investment in the United States and hint that capital may be redirected from existing investment sites to states with more favorable tax policies.

8-9 Government negotiators from Japan and the United States hold talks in Tokyo to discuss reform of Japan's financial markets. The American delegates urge the Ministry of Finance to allow U.S. financial institutions to engage in trust banking in Japan. Finance officials refuse to make a quick decision but promise to keep negotiating on this and the 22 other items related to capital market liberalization that Washington raised during the discussions.

13-15 During high-level talks in Tokyo, the European Community Commission again calls on Japan to import more manufactured goods from EC nations, as well as ease certification standards, liberalize financial and service markets, simplify the distribution system and tighten anti-counterfeit measures. The head of the delegation says the EC is considering the creation of an EC-Japan committee to solve bilateral trade issues.

16 The Ministry of Posts and Telecommunications announces its proposals for opening the domestic telecommunications equipment and services market to the private sector. The ministry also outlines its plans to privatize NTT.

21 Prime Minister Nakasone restates his commitment to defending the sealanes approaching Japan to 1,000 nautical miles, saying Japan has been lax in pursuing this goal.

22-23 Following up on the November 1983 bilateral agreement on yen internationalization, the first meeting of the Joint Japan-U.S. Ad Hoc Group on Yen/Dollar Exchange Rates, Financial and Capital Market Issues is held in Tokyo. Arguing that the yen will remain undervalued relative to the dollar unless Tokyo alters regulations that make the Japanese currency less attractive to hold, the American delegation pushes for changes in these policies. Also on the U.S. agenda are the related subjects of liberalization of Japanese interest rates, flexible expansion of financial offerings, further development of capital markets and fewer restrictions on direct investment in Japan. The meeting leaves both sides dissatisfied, with American negotiators saying they want a plan by the next meeting outlining fundamental changes in Japan's financial markets and the Japanese participants upset that Washington does not understand why current policies can only be changed gradually.

March 1984

8-10 American and Japanese negotiators again tackle the issue of legal protection in Japan for authors and users of computer programs. The U.S. team reiterates its strong opposition to a Ministry of International Trade and Industry plan to grant patent protection to software for 15 years while requiring program authors to license their work. The MITI proposal is also under attack from the Ministry of Education, which favors extending the nation's Copyright Law to cover software and protecting programs for 50 years.

12 The head of the National Aeronautics and Space Administration arrives in Tokyo to seek Japanese participation in the proposed U.S. manned space station. He suggests that Japan cover 10 to 15 percent of the program's estimated $8 billion cost, emphasizing the huge potential payoffs from participation.

13 In an about-face, Commerce Secretary Malcolm Baldrige says that an extension of Japan's restraints on car exports to the United States beyond March 1985 is unnecessary.

15 Prime Minister Nakasone and LDP secretary general Rokusuke Tanaka indicate that they want a discount rate cut to shore up the business recovery. Haruo Maekawa, governor of the Bank of Japan, in a response the following week, says it is "premature" to talk about a more accommodative monetary policy, stressing that the widening gap between interest rates in the United States and Japan is making foreign exchange markets unstable and necessitates caution.

22-23 U.S. and Japanese negotiators continue financial liberalization talks in Tokyo. The Japanese delegation spells out its plan for decontrol, but this proposal does little to defuse U.S. criticism. Treasury Secretary Donald Regan, meeting with Finance Minister Noboru Takeshita shortly after the discussions end, expresses strong dissatisfaction over the slow progress of the talks.

22-24 Working-level talks on a new agreement covering Japan's beef and citrus quotas reach an impasse, jeopardizing a settlement by the March 31 deadline. Although Tokyo tables a new offer, Washington continues to hold out for bigger increases, arguing that it has already made a major concession by shelving its long-standing demand for an import liber-

alization timetable. Prime Minister Nakasone, after conferring with top government and party officials, decides to send Agriculture Minister Shinjiro Yamamura to Washington to try and break the deadlock.

27-30 Negotiations on a new bilateral civil air transport accord are again sidetracked by operational issues connected with the June 1982 interim air services pact.

28 Prime Minister Nakasone says that the government's policy of keeping defense expenditures below 1 percent of GNP is a guideline that could change "under certain circumstances." Nevertheless, he reiterates that his administration will abide by the policy.

30 After trading in a very narrow range against the dollar — ¥234.8 to ¥233 — during January and February, the yen closes the first quarter of 1984 at ¥224.7= $1.00.

31 Figures for 1984's first quarter indicate considerable strength in the Japanese economy, with real GNP increasing at an annual rate of 6.7 percent. Once again the principal engine of growth is net exports, although domestic private sectors continue to show signs of recovery.

31 Japan's trade surplus totals $4.5 billion in the January-March 1984 period, $2.8 billion more than in the year-earlier quarter. Meanwhile, the United States reports that the trade deficit with Japan jumped from $5 billion in 1983's first quarter to nearly $8.1 billion.

April 1984

1 The annual ceiling on Japan's U.S.-bound car exports goes up from 1.68 million units to 1.85 million. Roughly 30 percent of the increase is allocated to General Motors Corp.'s two Japanese affiliates, with Japan's other smaller exporters getting larger percentage hikes than the top three suppliers.

3 The cabinet approves a bill reorganizing Japan's tobacco monopoly, the Japan Tobacco and Salt Public Corp., into a semi-governmental company effective April 1, 1985. The legislation, while leaving manufacturing in the hands of the new firm, will open the import and wholesale business to foreign companies. American firms claim the bill will have no effect on sales of imported cigarettes because it fails to eliminate the root problem — discriminatory pricing — that effectively limits foreign competition in the lucrative cigarette market.

6 The cabinet approves a compromise Ministry of Posts and Telecommunications-MITI proposal to deregulate the domestic telecommunications equipment and services market effective April 1, 1985. Although the plan removes all restrictions on foreign-affiliated companies entering Japan's value-added services market — a major U.S. objective, Ambassador Mansfield expresses concern that some sections of the proposed legislation are too vague and would allow MPT to exclude American firms from the market.

7 Japan agrees to expand its beef, orange and citrus juice import quotas by significant margins over the next four years. Settlement of this increasingly contentious bilateral trade issue is unexpected. Three days of negotiations in Washington between USTR Brock and Agriculture Minister Yamamura had ended in yet another impasse. At the insistence of Prime Minister Nakasone, however, the Japanese delegation returned to the bargaining table, and in quick order the two sides bridged their differences.

10 The Diet approves the FY 1984 general account budget, the most austere in 29 years. Expenditures will rise only 0.5 percent, with cuts in all areas of discretionary spending except defense, foreign assistance, and science and education.

11 The Federal Trade Commission gives General Motors and Toyota Motor Corp. the green light to jointly produce subcompact cars in Fremont, California. Despite the delay in winning clearance, the partners say they will start operations in December as originally scheduled.

12-13 The U.S.-Japan high technology working group meets in Hawaii, but reports no progress in resolving differences over Japan's proposals for protecting software.

16-17 Japanese and American officials meet in Washington to resume discussion of financial market liberalization in Japan. Although the Japanese side feels the talks are quite successful, Treasury Department officials say that major problems remain, particularly the issue of liberalizing the Euroyen market.

19 Finance Minister Takeshita calls on the Tokyo Stock Exchange and securities industry to study ways of enabling foreign concerns to become members of the exchange — one of the outstanding issues in the financial liberalization talks.

23 Washington agrees to put a two-year hold on the complaint it had filed with the General Agreement on Tariffs and Trade in July 1983 on 13 of Japan's 22 agricultural import quotas in exchange for Japanese concessions on some of these products.

25 Nippon Kokan K.K. announces that it will purchase 50 percent of National Steel Corp. for $292 million in the largest venture between an American and a Japanese steelmaker.

26 The head of the United Auto Workers union says in Tokyo that he supports an extension of Japan's export curbs on U.S.-bound cars as well as local content legislation. The

UAW chief insists that despite record profits in 1983, the U.S. auto industry still needs protection.

27 Japan unveils another market access package — the fifth in recent years — aimed at placating the United States and other major trading partners. Tariff cuts head the list of initiatives, but Tokyo also says it will relax the regulations covering purchases of foreign communications satellites by the private sector and NTT and liberalize the domestic telecommunications market on the basis of equal treatment for foreign firms. The government pledges as well to pursue financial market liberalization "independently, actively and steadily." While generally pleased with the package, the Reagan administration complains that many of the measures are vague. It also calls the proposed tariff changes "too little, too late."

May 1984

1 Citing record profits in 1983 for American automotive manufacturers and booming executive compensation, USTR Brock argues that Japan's restraints on U.S.-bound car shipments, now in their fourth year, should be allowed to expire next March. Vice President Bush, in Tokyo, is quick to state that the White House has not decided whether to lobby Japan for another extension of the restraints.

1 Sen. John Danforth (R, Mo.) introduces a telecommunications bill designed to counter the international trade impact of the Bell System breakup by raising duties from the current 4 to 13 percent range to 35 percent if negotiations with other countries for U.S. suppliers to secure greater market access do not produce satisfactory results within three years.

1 The Working Group on Unitary Taxation, an advisory body established by President Reagan in late 1983, concludes its review of the controversial system. Many issues are left unresolved, but the panel does agree that states should subject a portion of a company's national earnings to state corporate taxes but exclude its international operations.

8 The Japan Defense Agency begins drafting a new five-year build-up plan for FY 1986-FY 1990 to achieve the defense capability outlined in the 1976 National Defense Program. The outline calls for beefing up Japan's defense until it is capable of repelling "limited and small-scale" aggression "without external assistance."

8 Surprising many U.S. officials, LDP vice president Susumu Nikaido hints that the ruling party is ready to urge Japan's auto industry to limit car exports to the United States after the current restraint program expires March 31, 1985.

9-10 Vice President Bush meets in Tokyo with top government officials to review progress in implementing bilateral economic agreements and to discuss efforts to open Japan's financial markets and internationalize the yen — Washington's main priority, according to Mr. Bush. Although he calls the recent market access package a very positive step, the vice president adds that it leaves a number of problems untouched.

11 Nissan Motor Co., Ltd. announces that it will build cars as well as trucks at its assembly plant in Smyrna, Tennessee starting in April 1985.

15 Japan and the EC agree at a ministerial conference in Brussels to set up a joint committee to help expand exports of manufactured goods to Japan.

15-16 Ruling on a U.S. complaint brought in November 1982, a GATT arbitration panel concludes that Tokyo's quantitative restrictions on leather imports violate international trade rules. It calls on Japan to lift the quotas that have limited U.S. leather sales to 1 percent of the market.

16 The Senate approves by voice vote a bill to extend copyright protection to semiconductor designers.

17 Japan calls for a new round of multilateral trade talks at a ministerial meeting of the Organization for Economic Cooperation and Development.

18 The Diet passes a series of market opening and financial liberalization measures that include allowing the issuance of government bonds in overseas markets; extending the deadline for submission of financial statements by foreign companies listed on the Tokyo Stock Exchange; expediting import financing by the Export-Import Bank of Japan; and expanding contributions to the World Bank and other multilateral organizations.

29 The Joint Japan-U.S. Ad Hoc Group on Yen/Dollar Exchange Rates, Financial and Capital Market Issues submits its final report to Treasury Secretary Regan and Finance Minister Takeshita. The report details 12 specific concessions made by Tokyo in the areas of the Euroyen market, the domestic capital market and access by foreign financial firms to Japan's capital market, as well as six changes Tokyo is expected to make in the very near future. Detailed as well are four issues on which the two sides failed to reach agreement. Despite the remaining problems, Mr. Regan applauds the report, adding that over the long run the changes imply a rise in the yen's value.

June 1984

6 During talks in Tokyo with Agriculture Minister Yamamura and other government officials, Agriculture Secretary John Block pushes hard for tariff cuts on processed wood products, saying this is now a top U.S. priority in the trade field.

7 The Senate approves 91-3 a resolution calling on Japan and members of the North Atlantic Treaty Organization to expand defense spending and assume security responsibilities proportional to their economic and political stature.

7-8 The tenth annual summit meeting of the leaders of the major industrial democracies is held in London. The participants hammer out a plan to help hard-pressed developing country debtors and pledge to hold back protectionist pressures. Both Japan and the United States push for a firm starting date for a new round of multilateral trade negotiations but run into resistance from the Europeans. Recent Japanese market opening measures are rewarded by muted criticism of Tokyo's policies — a victory for Mr. Nakasone.

11 The House of Representatives unanimously approves its version of the Semiconductor Chip Protection Act passed by the Senate in May.

12 By a 3-2 vote the International Trade Commission rules that increasing steel imports in five major product lines are a substantial cause of the U.S. steel industry's serious problems. Japan and the EC denounce the finding, made in a 201 case initiated by Bethlehem Steel over the objections of other domestic makers.

15 The spring "wage offensive" brings meager gains to Japanese labor, falling slightly short of 1983's increase with an average 4.5 percent hike.

19 MITI releases its annual white paper on international trade, which calls on Japan to open its markets, expand domestic demand and promote industrial and economic cooperation with its trading partners. The report emphasizes that Japan, with its surplus capital, should endeavor to contribute to the growth of the world economy.

25-27 Japanese and U.S. defense officials at talks in Hawaii agree to improve the joint operation of their armed forces and related support systems. The U.S. side urges the Japanese to work to improve their sustainability. To this and other requests, the Japanese delegation responds with a pledge to make "maximum efforts" to comply.

29 The prime minister asks the government's tax council to review the current tax system in order to find new revenue sources.

29 After appreciating slightly in April, the yen moves back to the ¥233-¥231 range during May and the first half of June before falling against the dollar in the month's second half. The Japanese currency ends the second quarter of 1984 at ¥237.5=$1.00.

30 The Japanese economy puts in another solid performance during the second quarter of 1984, thanks to booming net exports and strong capital spending. Real GNP figures show the economy expanding at an annual rate of 4.7 percent.

30 At mid-year Japan's trade surplus stands at $13.5 billion, up $6 billion from 1983's first half. The U.S. trade deficit with Japan also continues to climb, jumping from $10.2 billion to $17 billion.

July 1984

11 A deeply divided ITC recommends to President Reagan that he impose quotas, extra duties or tariff quotas for the next five years on roughly 70 percent of the steel entering the United States. The three commissioners voting for the complex relief package suggest, however, that protection be conditional on an industry commitment to improve competitiveness. Foreign reaction to the relief recommendation is predictably negative.

11-13 At the 21st annual Japan-U.S. Businessmen's Conference in Tokyo, the participants agree that facilitating market access and encouraging free flows of trade and technology are the best ways to reduce bilateral trade frictions.

17 The lower house of the Diet approves a plan to reorganize the Japan Tobacco and Salt Public Corp. into a semi-public company April 1, 1985 and liberalize import and distribution procedures for foreign-made cigarettes.

20 The Diet's lower house approves three measures to convert NTT into a semi-governmental company and open Japan's domestic telecommunications market to the private sector April 1, 1985. Foreign firms will be able to freely enter the secondary services market (data and specialized communications) but can only provide common carrier services if foreign ownership is one-third or less.

31 The cabinet approves MOF's guidelines for the FY 1985 budget. The growth of general expenditures is to be held to an all-time-low of 0.86 percent.

31 Treasury Secretary Regan forwards a series of recommendations to the president on how to deal with the unitary tax issue. The report urges states to limit application of the unitary tax or face the possibility of federal legislative or administrative actions. The recommendations do little to mute Japanese criticism of this system of taxation.

August 1984

3 The Diet's upper house passes the five-bill package that will reorganize JTS into a semi-public company and liberalize the import and distribution of foreign-made cigarettes.

7 The Economic Planning Agency issues the 1984 economic white paper, which urges the internationalization of the yen and increased overseas direct investment to ease frictions with Japan's trading partners.

9 The Diet adjourns before the upper house finishes work on the bills to transform NTT into a semi-public business and open the domestic telecommunications market to competition.

15-16 Defense officials from the United States and Japan meet in Washington to continue work on establishing a framework for transfers of defense-related technologies.

22-23 Deputy USTR Smith, visiting Japan, reiterates U.S. opposition to software protection legislation proposed by MITI.

September 1984

4 An economic policy panel set up by Prime Minister Nakasone holds its first meeting to study measures to spur private-sector spending and insure continued Japanese growth.

4-7 Bilateral discussions on a new civil air transport agreement, held in San Diego, again fail to make any notable headway. A new operational issue crops up during the meeting: Tokyo's demand that Japan's first all-cargo carrier be allowed to start service to the United States.

12 Visiting Tokyo, Treasury Under Secretary for Monetary Affairs Beryl Sprinkel expresses confidence that new U.S. government bonds intended specifically for foreign purchase will find a ready market in Japan. He also reaches agreement with his Finance Ministry counterpart to follow up the May report of the bilateral yen-dollar group.

13-21 After a lull in bilateral negotiations that has stretched through the summer, the United States and Japan resume discussion of a wide range of economic subjects in Washington. Old disagreements resurface — software protection, access to Japan's deregulated telecommunications market, purchases of satellites by the private sector and U.S. access to the Japanese policymaking process. The American participants also raise some new issues, including excessive Japanese investment in semiconductor production facilities. But the adversarial atmosphere of earlier meetings is absent, in large part because of approaching elections in both countries.

14 JDA releases its annual white paper, stressing the importance of increased defense spending to meet security goals. The study also declares that the Soviet Union is the principal military threat to Japan.

17 In its final report to President Reagan and Prime Minister Nakasone, the U.S.-Japan Advisory Commission concludes that although major disagreements do not exist between the two countries, an unacceptable level of friction prevails that dilutes the potential benefits of the relationship. The study points out that many of the trade problems facing the two countries result from domestic macroeconomic policies and not from unfair trade practices. The report says the United States must reduce its budget deficit to help lower interest rates and reduce the value of the dollar. It also calls on Japan to take a greater role in stimulating global economic expansion. The commission was organized in May 1983.

19 President Reagan rejects the ITC recommendation in the 201 case initiated by Bethlehem Steel to impose quotas, extra tariffs or tariff quotas on roughly 70 percent of U.S. steel imports. He announces instead that the United States will seek voluntary restraint agreements with major suppliers. These arrangements could have the same effects as the ITC recommendation since administration spokesmen say the goal is to roll back imports of finished steel to 18.5 percent of the U.S. market. Japan labels the president's move unjustifiably protectionist.

24 JDA director general Yuko Kurihara meets in Washington with Defense Secretary Caspar Weinberger to discuss mutual security matters and outline Japan's continuing efforts to meet the goals of its five-year defense program.

25 Foreign Minister Abe and Soviet Foreign Minister Andrei Gromyko meet in New York and agree to resume annual bilateral economic talks. Japan suspended the talks in 1982 to protest Soviet actions in Poland. Mr. Gromyko declines an invitation to visit Tokyo.

28 Continuing to lose ground against the dollar as it has since mid-June, the yen closes out 1984's third quarter at ¥245.5=$1.00 after hitting a 22-month low of ¥248.3=$1.00 on September 18.

30 Despite an improving domestic economic performance, Japanese growth slows unexpectedly in the third quarter because of a falloff in the expansion of exports and a pickup in the pace of imports. Real GNP figures indicate the economy is growing at an annual rate of only 2.7 percent.

30 Japan's mounting trade surplus shows no signs of slackening. At the end of 1984's third quarter exports top imports by $22.3 billion compared with $14.4 billion in the year-earlier period. Conversely, the U.S. trade deficit with Japan jumps from $15.3 in the January-September 1983 period to $28.4 billion.

October 1984

5 The U.S. automotive industry's campaign for extension of Japan's restraints on U.S.-bound car shipments beyond March 1985 is kicked off when the head of Chrysler

Corp., in a letter to President Reagan, argues for two more years of Japanese export restrictions. Ford Motor Co.'s chairman and the UAW's president sound a similar theme in an October 17 appeal to the president.

8 MITI says it plans to submit legislation aimed at protecting the designs of integrated circuits to the next Diet session. The bill, modeled after U.S. legislation, will grant 10 years of copyright protection to chip designers.

9 The Ministry of Foreign Affairs releases its annual Blue Book, a survey of relations with other countries, which urges steps toward nuclear disarmament, stresses the need to promote stability in Asia, and advises improving Japan-Soviet relations. As before, the study refers to relations with the United States as the cornerstone of Japan's international policy.

9 On the eve of adjournment, Congress rushes through a conference report on a comprehensive package of trade measures that is less protectionist than the bills originally passed by the House and Senate. The measure extends the Generalized System of Preferences, authorizes a free-trade zone with Israel, broadens the president's authority to retaliate when U.S. trading partners fail to give American exporters "fair and equitable" market access.

9 Congress approves copyright protection for microchip designs. Circuit designs registered or exploited after January 1, 1983 will be granted protection for 10 years.

11 Controversy over national security export controls prevents the passage of a revised and extended Export Administration Act before Congress adjourns.

11 President Reagan signs legislation easing antitrust restrictions on joint research by American companies.

16 U.S.-Japan commercial whaling talks crumble. Washington demands that Japan refrain from hunting sperm whales — an endangered species — in U.S. coastal waters and threatens a further reduction in Japan's fish quotas.

22-23 U.S. trade negotiators hold informal talks with their Japanese counterparts on a steel restraint arrangement. The American side asks Tokyo to reduce its U.S.-bound steel shipments "substantially" but gives no numbers.

29 The filing deadline for the LDP presidency passes with Prime Minister Nakasone the only candidate registered, assuring him two more years as party head and prime minister of Japan.

30 In a first, MITI invites foreign business representatives to attend meetings of the joint planning subcommittee of the Industrial Structure Council as "non-regular members."

30 President Reagan signs into law the omnibus trade package passed by Congress earlier in the month.

31 Prime Minister Nakasone reshuffles his cabinet. He retains Finance Minister Takeshita and Foreign Minister Abe, indicating a continuation of the basic thrust of policies initiated during the last two years.

November 1984

6 Mr. Nakasone is formally designated LDP president at the party's convention.

6 The Joint Military Technology Commission meets for the first time in Tokyo to lay the groundwork for transfers of military technologies of interest to the United States. The commission was created to review and facilitate U.S. requests for Japanese defense-related technologies.

9 The United States and Japan reach a compromise on fishing and whaling rights that delays an outright ban on Japanese commercial whaling or the imposition of sanctions for two more seasons. In exchange, Japan agrees first to withdraw its objections to the ban on sperm whaling and later to withdraw its objections to the commercial whaling moratorium.

14-15 Finance officials from the United States and Japan resume financial liberalization talks in Tokyo. The American participants, while acknowledging that the May agreement to deregulate Japan's financial markets and internationalize the yen has yielded positive results, express strong dissatisfaction with the pace of change. Japanese representatives counter that the reforms envisioned are not easy to plan or implement. The U.S. side also lists 10 specific areas in which additional progress is needed.

15-23 Foreign Minister Abe tours African countries and pledges $50 million in food and aid to famine-stricken nations.

16 Commerce and USTR officials, during an "informal" visit to Tokyo, preview the issues that are likely to comprise the bilateral trade agenda in 1985. Japan's handling of standards and testing for telecommunications equipment after Tokyo's telecommunications reforms go into effect is cited as the top priority. Japan's tariffs on processed wood products and software copyright protection are also mentioned.

25 Mazda Motor Corp. unveils plans to build a car assembly facility in Flat Rock, Michigan, with startup production scheduled for the fall of 1987. Mazda will be the fourth Japanese automotive maker building cars here.

26-27 The initial round of bilateral negotiations on a Japanese steel export restraint pact ends in a stalemate.

28 The LDP's secretary general criticizes the Finance Ministry's insistence on another austere budget. By calling for tax increases to finance public works, however, the LDP official sparks a harsh attack from Keidanren and other groups.

30 The United States, the EC, Canada and Japan issue a formal call for a new round of multilateral trade negotiations at the GATT annual meeting. With the United States and developing countries split over whether services should be included in the new round, the participants agree to postpone formal discussion of this topic until November 1985. In the meantime, the GATT is to conduct an analysis of global trade in services.

December 1984

1 The Diet convenes almost three weeks earlier than usual, in part because the telecommunications reform bills must still be passed.

3-5 The United States and Japan come to terms on the broad outlines of a steel restraint agreement. Although Washington accepts a new compromise offer from Tokyo to restrict shipments of steel mill products to 5.8 percent of the American market in exchange for a guarantee that no trade or antitrust suits will be filed against Japanese steel exporters, many details are left hanging.

14 The upper house of the Diet passes the package of telecommunications reform bills after failing to act on the legislation during the previous session.

14 Japan announces new market opening measures designed to help developing countries. The package features accelerated tariff cuts on more than 1,000 manufactured products and agricultural commodities of special interest to these suppliers.

19 Defense Secretary Weinberger invites Japan and NATO allies to participate in the Strategic Defense Initiative, popularly known as "Star Wars."

19 The government's and the LDP's tax councils unveil proposals for revenue-generating tax reforms to be implemented in April 1985. Most of the changes would fall on corporations.

20 The lower house of the Diet reapproves the three-bill package of telecommunications reforms, paving the way for the deregulation of Japan's domestic telecommunications market and the privatization of NTT effective April 1, 1985. Passage of the legislation does not end the bilateral dispute over the reforms, however, as the United States immediately reiterates its concerns about standards, testing and certification procedures.

22 The Economic Planning Agency projects Japan's real economic growth in FY 1985 at a moderate 4.6 percent, down from FY 1984's revised forecast of 5.3 percent but still higher than the initial estimate for that year. Domestic demand is expected to power the expansion, accounting for 4.1 percentage points of total GNP growth. Private forecasters are generally less optimistic about the economy's growth prospects.

24 The cabinet approves a draft budget for FY 1985 that provides for a 3.7 percent increase in general account expenditures. All of the increase, however, is earmarked for debt servicing and transfers to local governments.

27 Prime Minister Nakasone, in a meeting with business leaders, rules out import targets to balance U.S.-Japan trade. He also indicates that overhaul of the tax system will not begin until after fiscal 1986.

31 The yen closes out 1984 at ¥251.1=$1.00, 7.5 percent less than on the year's first trading day, after continuing to lose ground for much of the fourth quarter.

31 Thanks to an unexpectedly strong fourth quarter, the Japanese economy turns in its best annual performance since 1973, expanding 5.1 percent in inflation-adjusted terms. Real GNP growth in the October-December period measures 8.9 percent at an annual rate — a result due largely to resurgent exports and reduced imports, although a big jump in capital spending and revived housing construction also makes a contribution.

31 The pivotal role of exports in Japan's 1984 economic expansion is underscored by its record $33.6 billion trade surplus — $13.1 billion higher than 1983's tally. Most of this jump reflects the growing imbalance in trade with the United States, which reports that the bilateral trade deficit climbed from $21.7 billion in 1983 to $36.8 billion.

January 1985

2 With the ballooning bilateral trade deficit fueling protectionist fires in the United States, Prime Minister Nakasone meets with President Reagan in Los Angeles. Japan's premier surprises his host by broaching the subject of Washington's concern that American suppliers might not have the same access to Japan's deregulated telecommunications equipment and services market as their Japanese competitors. With this opening, President Reagan raises the general problem of limited market opportunities in Japan for U.S. exporters, citing processed wood products, pharmaceuticals and medical equipment, sophisticated electronics products and telecommunications equipment in particular. Mr. Nakasone proposes a series of high-level negotiations, dubbed market-oriented, sector-selective (MOSS) talks, in the

four areas singled out by President Reagan — an initiative that wins quick backing from the U.S. side. While trade issues dominate their fifth meeting, the two leaders do touch on foreign policy and security matters. Mr. Nakasone seeks and receives assurances that Japanese and Asian security interests not be neglected during upcoming U.S.-U.S.S.R. arms control talks. Japan's prime minister also expresses his "understanding" of President Reagan's Strategic Defense Initiative.

8 Prime Minister Nakasone gives his cabinet a late March deadline for mapping out additional measures to facilitate sales of American-made products in Japan, particularly telecommunications equipment, forest products, medical equipment and pharmaceuticals and electronics products. He also stresses the need for stronger steps to liberalize domestic financial markets — a call echoed by new Bank of Japan governor Satoshi Sumita.

8 Japan and the Soviet Union agree to limit Minke whaling despite their refusal to abide by International Whaling Commission ceilings.

10 The Japanese National Railways unveils its own proposal for reorganization, recommending privatization of the state-run system effective April 1987. The plan would reduce the number of employees, transfer many local lines to private companies, and pay off long-term debts. The proposal is immediately criticized by the government's JNR reform commission as inadequate.

10 Tokyo agrees to rescind the 20 percent withholding tax on interest income on Euroyen bonds owned by non-residents, a change for which the United States had pressed hard.

13 Trade negotiators for the United States and Japan, meeting in Tokyo, again fail to iron out final details of an arrangement to limit U.S.-bound shipments of Japanese steel mill products to 5.8 percent of the American market.

17 LDP vice president Nikaido, in Washington for President Reagan's inauguration, tells administration officials that even if Japan's restraints on car exports are lifted, exports will go no higher than 2.5 million units. Japanese auto manufacturers promptly dispute his prediction, but U.S. proponents of continued restrictions latch on to the remark as evidence that the restraints must remain in place beyond March.

17 Finance and Treasury officials from the United States, Japan, Britain, France and West Germany meet in Washington to discuss the recent sharp rise in the dollar's value and the growing volatility of exchange rates.

18 The head of the JDA tells DOD assistant secretary Richard Armitage during a Tokyo meeting that Japan does not intend to lift its defense spending ceiling.

22-23 In Tokyo, Japan and the Soviet Union hold bilateral trade talks — the first in four years but fail to conclude a long-term economic cooperation treaty. Japanese officials claim that negotiations on a return of the four islands north of Hokkaido occupied by the Soviets since the end of World War II must accompany any economic talks.

23 In a friend-of-the-court brief, the Justice Department urges the U.S. Supreme Court to reverse an appeals court ruling that a 15-year-old civil antitrust suit against Japan's major consumer electronics makers should go to trial. In its suit Zenith Electronics Corp. charged the companies with conspiring to drive their U.S. rivals out of business by dumping, price fixing and other means.

29-30 Japan and the United States hold the initial round of MOSS negotiations in Tokyo. The subcabinet-level talks get off to a slow start. The American participants say the United States expects nothing less than a complete overhaul of the formal and informal barriers that impede foreign access to Japan's markets. They add that there are no deadlines for completing the talks but that progress is expected, especially on the high-priority issue of market opportunities for U.S. suppliers of telecommunications equipment and services. During informal discussion of this issue, American officials concentrate on the administrative guidelines being drafted by the Posts and Telecommunications Ministry to cover market entry and equipment testing and certification procedures. Japanese negotiators repeatedly reassure their U.S. counterparts that foreign companies will receive fair treatment.

February 1985

4 The Defense Department releases its annual report, urging Japan to build up its national defense capabilities, including protection of the sealanes to 1,000 nautical miles south and east of Japan by the 1990s.

9-11 During talks held in Kyoto, top trade officials from Japan, the United States, the EC and Canada agree to pursue further discussions on a new round of multilateral trade negotiations, with the goal of starting hard bargaining as early as 1986.

12 USTR Brock warns Prime Minister Nakasone about rising protectionism in Washington and stresses that Tokyo must move quickly to open Japanese markets to imports. Mr. Nakasone again requests that Washington lift its ban on Alaskan crude oil exports to help redress the bilateral trade imbalance. Also necessary, he says, is a narrowing of the interest rate gap between the two countries. In a subsequent meeting with MITI Minister Keijiro Murata, Mr. Brock, echoing a message he delivered to the prime minister, states

that Japan could face "serious consequences" if substantial progress is not made toward solving the problem of foreign access to the Japanese telecommunications equipment and services market. He adds that Tokyo's proposed regulations are "completely unsatisfactory."

13 During questioning in the Diet, Prime Minister Nakasone says Japanese participation in President Reagan's Strategic Defense Initiative is a possibility. He adds that the 1983 notes enabling bilateral transfers of dual-use technology and the mutual security treaty would allow Japan to export technology for use in SDI research and development programs.

13 The yen hits its lowest daily median against the dollar since November 1982, trading at ¥263.4.

19 The Cabinet Council on Commerce and Trade unanimously recommends that President Reagan not ask Japan for a fifth year of restraints on U.S.-bound car shipments.

20 Prime Minister Nakasone rules out early lower house elections.

22 Mr. Reagan refuses to commit himself at a news conference on whether he will ask Tokyo for another year of export restrictions on cars. The president suggests that his decision hinges on the steps Japan takes to improve market opportunities for U.S. exporters of telecommunications equipment and services and other products — a linkage cabinet officials reportedly shunned.

26 Formal MOSS negotiations get off to a shaky start. To signal Washington's unhappiness with Japan's proposed standards, testing and certification procedures for telecommunications equipment, Commerce Secretary Baldrige instructs chief U.S. telecommunications negotiator Olmer to skip the meeting scheduled for this subject. A shouting match erupts in the forest products talks after the American delegation calls on Japan to eliminate "all barriers," especially tariffs, to trade in these products. The discussions on electronics are little more than a fishing expedition by the U.S. side, while market access problems in the pharmaceuticals/medical equipment area are not even discussed.

26 Former Prime Minister Kakuei Tanaka, still regarded as the most powerful figure in Japanese politics despite his conviction in the Lockheed bribery scandal, is hospitalized with a stroke. Concern over Mr. Tanaka's health throws the LDP factional balance into question.

27 Twelve days of marathon talks in Washington to finalize details of an arrangement limiting Japan's exports of steel mill products to the United States to 5.8 percent of the market end with negotiators so divided they differ on the outcome of the discussions.

March 1985

1 President Reagan announces that he will not ask Tokyo to extend restraints on shipments of Japanese-made cars to the United States for a fifth year. The decision is greeted by a hail of criticism from Chrysler, Ford, the UAW and congressional supporters of continued auto industry protection. The reaction in Japan is predictably favorable, although government officials had hoped the administration would signal how many additional cars could be shipped to this country without triggering a political backlash. The president rejects an explicit trade-off with improved market opportunities in Japan for U.S. exporters, but clearly indicates that he expects progress on this issue.

1 Although a deal that would allow Japan's first all-cargo airline to start service to the United States is in the works, bilateral aviation negotiations end in Tokyo without an agreement.

1 The United States and Japan eliminate their tariffs on semiconductors, which had been set at 4.2 percent.

5 A U.S. district court strikes down a November 1984 Japan-U.S. agreement that dictated a gradual phaseout of sperm whale harvesting by Japan in exchange for continued Japanese access to U.S. fishing waters.

5 As a step to internationalize the yen, the Finance Ministry announces that it will create a Tokyo offshore banking facility in FY 1986.

6 The lower house of the Diet approves an austere FY 1985 general account budget. Despite an unsuccessful week-long opposition party boycott to force the governing coalition to accept a cut in personal income taxes, the budget passes virtually unchanged. Total spending will increase 3.7 percent and, although there will be no change in discretionary expenditures, a 6.9 percent rise in defense spending and a 10 percent hike in foreign aid are approved.

8 Testifying before a Senate subcommittee, Commerce's Olmer spells out specific U.S. objections to the regulations drafted by the Posts and Telecommunications Ministry for the soon-to-be-open Japanese telecommunications market. He makes the same points in a letter to his MPT counterpart, who has taken the unusual step of allowing foreigners to review the proposed rules.

13 After six months of often contentious negotiations, Japan and the United States finally iron out the details of an arrangement limiting U.S.-bound shipments of Japanese steel mill products to 5.8 percent of the American market. The restraints will remain in place for five years, with a retroactive starting date of October 1, 1984. Virtually all Japanese steel shipped to this country is covered either through limits on six

broad product categories or monitoring.

14 Prime Minister Nakasone, in Moscow for the funeral of Constantin Chernenko, holds talks with new Soviet leader Mikhail Gorbachev — the first meeting in 12 years between a Japanese prime minister and a Soviet party chief. Mr. Nakasone invites Soviet Foreign Minister Gromyko to visit Tokyo and Mr. Gorbachev promises to consider the proposal.

14-15 During subcabinet-level MOSS talks in Tokyo, Japanese negotiators signal their willingness either to change draft regulations for telecommunications equipment and services to accommodate U.S. concerns or to take other steps to improve foreign access to the deregulated Japanese telecommunications market. Afterward, chief U.S. negotiator Olmer sounds more optimistic about the prospects for reaching agreement before April 1 than he had earlier in the month.

18-19 Japan proposes the bilateral elimination of tariffs on a long list of electronics products, including computer parts, at the second round of MOSS talks on electronics products in Tokyo. It is also revealed that the Ministry of Education and MITI have compromised on a plan to extend copyright protection to software, thus assuring American programmers essentially the same protection in Japan that they receive at home. MITI representatives also discuss their proposal for protecting semiconductor designs, which is essentially a copy of the U.S. legislation.

19 Finance Minister Takeshita reassures members of the Diet budget committee that the government will not raise taxes. Business organizations ask the government to place top priority on balancing the budget through spending cuts rather than by tax increases.

27 The Defense Department formally requests Japanese participation in the Strategic Defense Initiative research and development program.

28 MITI Minister Murata announces that Japan will extend restraints on U.S.-bound car exports for one more year, with shipments capped at 2.3 million units. The decision to hike the export ceiling is denounced by spokesmen for Chrysler, Ford and the UAW as well as congressional supporters of U.S. auto industry protection. Reagan administration officials are also critical of the decision, indicating that Tokyo had misread Washington's signals on what to do about car exports after March 31. MITI defends its move, saying that without a fifth year of restraints, Japanese car exports would have been much higher than 2.3 million units.

28 The Senate unanimously passes a nonbinding resolution calling on the administration to retaliate against Japan for its perceived intransigence on expanding market access for American products.

29 The yen ends the first quarter of 1985 at ¥252.5=$1.00 — the exact same rate at which it opened the year — after hovering around ¥260 for most of February and March.

31 Japanese economic growth comes to a near standstill during the January-March period, with real GNP rising at an annual rate of only 1.7 percent. Capital spending marks time, while the external sector exerts a drag. A spurt in consumer spending and another expansion in housing construction provide about the only good news.

31 Japan's trade surplus continues to snowball in 1985's first quarter, climbing from $4.5 billion in the year-earlier period to $6 billion. So does the U.S. trade deficit with Japan, which jumps by $3 billion to $11.1 billion.

April 1985

1 NTT becomes a semi-public corporation — Nippon Telegraph and Telephone Corp. — and Japan's domestic telecommunications equipment and services market is opened to private competition as negotiators for the United States and Japan continue to wrangle over the ministerial ordinances implementing these sweeping reforms. Because of earlier Japanese concessions in such key areas as testing and certification procedures, differences of opinion are limited mainly to equipment standards and registration requirements for entry into the secondary services market.

1 JTS is transformed into a semi-public organization known as Japan Tobacco Inc. Both it and NTT are among the largest businesses in Japan, whether measured by capital, sales or employment. Import and distribution regulations are also changed to allow competition.

1 MOF continues the process of financial market liberalization by introducing several changes designed to expand the Euroyen market.

2 Following the Senate's lead, the House of Representatives passes a nonbinding resolution calling on the administration to retaliate against Japan's alleged unfair trading practices.

3 The Senate approves a new Export Administration Act to replace the legislation that expired in March 1984.

5 In a major turnaround, Tokyo says it is willing to abide by an International Whaling Commission moratorium on all whaling if the United States will allow Japan to take its normal fishing allocation during a two-year phaseout period.

5 The cabinet approves amendments to the Copyright Law to provide authors of software programs rights similar to those granted U.S.

programmers. The amendments, which provide 50 years of protection and make no provision for compulsory licensing, are now expected to win quick Diet approval. So is MITI's bill to grant exclusive patent-like commercial rights to original chip designers for 10 years. This bill was accepted by the cabinet March 19.

9 Japan unveils another package of market access initiatives that includes measures addressing issues of immediate concern to the United States as well as a pledge to continue the process of market liberalization and internationalization of Japan's economy over the next three years. What sets the package apart from earlier ones is the government's acceptance of the basic principle that access to Japanese markets for goods and services should be free, with restrictions limited to matters of national security and other exceptional situations. This approach will guide the preparation and implementation of a three-year "action program" designed to provide additional market opportunities in Japan for foreign suppliers.

15 The heads of Chrysler and Mitsubishi Motors Corp. initial a memorandum of understanding in Tokyo to set up an equally owned com-pany to assemble subcompact cars at a still-to-be-selected site in the Midwest starting in 1988.

16 The House of Representatives approves a new Export Administration Act.

17 OECD members agree in principle during a ministerial meeting in Paris to start a new round of multilateral trade negotiations but resist pressure from Washington to commit themselves to a specific starting date.

17 Reflecting the strong growth of corporate profits and productivity over the past year, Japanese industry offers labor wage increases averaging about 5.1 percent — half a percentage point higher than in 1984.

17-19 In what U.S. negotiators term a surprising move, Tokyo agrees to eliminate many of the technical standards for telecommunications terminal equipment. MPT also says it will enforce procedural transparency on all common carriers and Japan's international telecommunications monopoly.

19 The government and the LDP inaugurate a special task force, called the External Economic Policy Promotion Headquarters, to implement the market opening pledges announced 10 days earlier. The group, chaired by the prime minister, sets a July deadline for developing concrete plans.

24 U.S. Ambassador to Japan Mansfield, testifying before a Diet foreign affairs committee, urges Japan to beef up its market opening measures with substance, while stressing that Washington must make efforts to deal with the strong dollar, high interest rates and huge federal budget deficit.

30 Aviation negotiators for the United States and Japan initial an interim arrangement that allows Japan's first all-cargo carrier to start trans-Pacific service immediately, enables each country to designate three more trans-Pacific routes for nonstop combination passenger and cargo service starting in April 1986, and approves additional service between Japan and Micronesia. The arrangement will be folded into any agreement revising the 1952 pact that governs U.S.-Japan air transport services.

May 1985

1 With the Japan Federation of Bar Associations unable to reach a consensus on reforms to allow foreign lawyers to practice in Japan, USTR-designate Clayton Yeutter presents Tokyo with a list of U.S. proposals.

2-4 Representatives from the free world's seven major industrial powers, meeting in Bonn for the eleventh annual economic summit, issue a bland declaration to seek sustained global growth and increased employment. President Reagan and Prime Minister Nakasone are unable to win a firm commitment from the other participants to start a new round of multilateral trade talks.

9 The head of NASA and Japan's science and technology minister sign a memorandum of understanding covering Japanese participation in the preliminary design stage of the U.S. manned space station. Japan will be responsible for a multi-purpose experiment module.

9 Noting the failure of the Bonn summit participants to reach a consensus on the SDI program, the Foreign Ministry confirms that Tokyo will delay, possibly until the fall, announcement of a decision regarding Japanese participation in the program.

24 Following lower house passage April 19, the Diet's upper house approves legislation providing semiconductor designs the same protection granted under U.S. law.

30-31 Japanese and American trade negotiators hold a second round of talks in as many months on NTT's procurement policies. Administration officials, concerned that NTT will not feel bound to the terms of the procurement pact signed in January 1984 now that it is considered a private company, want Tokyo to set a target for NTT's purchases of foreign equipment, but this idea is rebuffed by the company's president.

31 The LDP introduces a bill to effect limited electoral reform by shifting six lower house seats from over-represented and primarily rural areas to under-represented urban districts. The party has been studying the issue since Japan's Supreme Court ruled in November 1983 that current

electoral districts are unconstitutional and must be redrawn "as soon as possible."

June 1985

1 As part of the continuing liberalization of financial markets, yen-denominated bankers' acceptances are traded for the first time; the number of banks allowed to trade outstanding government bonds jumps; securities houses begin trading certificates of deposit; and electronic trading comes to the government bond market.

3 Japan announces an emergency import package worth $2 to $3 billion in a further effort to alleviate trade frictions.

3-4 MOSS talks on telecommunications equipment move into a new area. During subcabinet-level discussions in Tokyo, the American delegation presses for changes in Japan's Radio Law, which, as currently written, limits sales of mobile telephones, paging devices and cordless telephones.

6 The Diet approves legislation amending Japan's Copyright Law to explicitly cover software.

7 Prime Minister Nakasone rules out the possibility of introducing an export surcharge to counter Japan's swelling trade surplus after some LDP leaders float the idea earlier in the week.

10 JDA director general Koichi Kato promises in Washington to make further efforts to increase Japan's sealane defense capability. In a meeting with Defense Secretary Weinberger, Mr. Kato asks for briefings on certain advanced systems, including long-range over-the-horizon radar, to facilitate their introduction into Japan's Self-Defense Forces. The two officials also discuss the 1983 agreement on defense technology transfers.

13 By an 88-7 vote, the Senate approves a resolution criticizing Japan for its failure to meet its defense commitments and for its consistently low defense spending levels.

14 With hard times again rocking the cyclical U.S. semiconductor industry, the Semiconductor Industry Association charges Japanese manufacturers with unfair trade practices in a complaint filed with the Office of the USTR under Section 301 of the 1974 Trade Act. The complaint seeks White House intervention on two fronts: to stop allegedly predatory pricing by Japanese vendors in the United States and to help American companies crack the Japanese semiconductor market, where, it is claimed, U.S. sales have never exceeded 10 or 11 percent of consumption for any sustained period because of an evolving set of barriers.

18 MITI's annual white paper on trade calls for increased imports, particularly of manufactured products, expansion of domestic demand and the early start of a new round of multilateral trade talks.

21 Finance ministers and central bank governors from major industrialized countries wind up a one-day meeting in Tokyo without agreement on specific steps to stabilize world currency markets.

22 Finance Minister Takeshita tells Treasury Secretary James Baker, in Tokyo for the Group of Ten meeting, that all nine foreign banks, including six U.S. banks, that applied to conduct trust banking operations in Japan will be allowed to do so. The Japanese official also says that the Tokyo Stock Exchange will revise its rules, perhaps as early as the fall, to allow foreign firms to buy seats on the exchange.

24 Deputy USTR Smith tells a congressional hearing that the MOSS negotiations are moving at "glacial speed."

24 Micron Technology Inc., a small Boise, Idaho memory manufacturer, charges Japan's six biggest semiconductor makers with dumping 64K DRAMs (dymanic random access memories) here at prices below production costs.

24-25 In another subcabinet-level follow-up meeting to the May 1984 yen-dollar accord, held in Tokyo, the Japanese delegation presents a timetable for liberalization of interest rates on large deposits and outlines plans to reduce the minimum size of money market certificates and allow a wider range of maturities on certificates of deposit. American participants reserve comment, saying they must study the proposals.

25 Japan fills in the details of the tariff changes it had promised in its April market access package. Roughly 1,800 of the 2,400-plus four-digit agricultural and industrial products in Japan's tariff schedule are slated for tariff cuts of at least 20 percent or duty-free treatment starting next April. The list features changes of particular interest to the United States, Europe and Asia. Tokyo proposes to Washington that both countries eliminate duties on a long list of high technology products. Japan also promises to improve its Generalized System of Preferences program. The Reagan administration's reaction to the tariff changes is surprisingly favorable, given that processed wood products and a number of other products in which Washington has expressed a strong interest are missing from the list.

25 The regular session of the Diet ends after legislators approve most of the major bills introduced by the cabinet. Several key issues, however, are left hanging, including educational reform, reorganization of the Japanese National Railways and redistribution of seats in the lower house.

27 Prime Minister Nakasone says that he intends to implement

drastic cuts in both corporate and individual income taxes.

27 Congress approves a conference committee report on the Export Administration Act.

28 The yen averages ¥248.95= $1.00 after trading within two yen plus or minus of the ¥250 rate during the second quarter.

30 The Japanese economy bounces back in 1985's second quarter, with real GNP increasing at a 5.7 percent annual rate. More than half of the expansion reflects a rebounding external sector. Domestic growth centers almost entirely on capital spending and housing construction.

30 Confirming the pivotal role of the external sector, Japan reports that its trade surplus at mid-year totals nearly $17.7 billion compared with $13.5 billion in the January-June 1984 period. Conversely, the U.S. trade deficit with Japan continues to deepen, moving from $17 billion to $24.2 billion.

July 1985

2 The Foreign Ministry releases its annual assessment of Japan's diplomatic relations. Essentially unchanged from previous analyses, the Blue Book does contain two notable observations: that Japan must open itself to the international community — and not only in the trade field — and that it must make strides socially and psychologically to adapt to its status as an international power. The report also includes "promotion of national security policy" as an element of Japan's over-all diplomacy, marking for perhaps the first time an overt understanding of a link between defense and diplomacy.

9 MITI Minister Murata rebuffs European and American calls for complete decontrol of Japan's import market for refined oil products at a ministerial session of the International Energy Agency. At present only imports of naphtha, heavy fuel oil and liquefied petroleum gas are unregulated.

10 Sen. Bob Packwood (R, Ore.) introduces a bill requiring retaliation against Japan for its unfair trade practices, a binding version of resolutions passed by both chambers of Congress in the spring.

11 Newly confirmed USTR Clayton Yeutter orders a 301 investigation into allegations of unfair Japanese trade practices in semiconductors in response to a Semiconductor Industry Association complaint.

11 By a voice vote, the House of Representatives approves a resolution critical of Japan's defense spending levels. A virtually identical resolution passed the Senate in June.

12 President Reagan signs the Export Administration Act into law.

12-21 Prime Minister Nakasone discusses Japan-EC trade and investment problems as well as multilateral matters, particularly security issues, with high-level French, Italian and EC officials during a 10-day trip to Europe.

17 Japan's Supreme Court rules the results of the December 1983 lower house elections unconstitutional because of the Diet's failure to reapportion election districts to reflect shifts in the voting population. The court, however, rejects demands that the election results be nullified.

17 Sen. Lloyd Bentsen (D, Tex.) introduces legislation mandating big import surcharges on goods from Japan and other countries that run large trade surpluses with the United States. The same bill is introduced in the House the next day by Dan Rostenkowski (D, Ill.) and Richard Gephardt (D, Mo.).

19 The Japan Federation of Bar Associations says it will revise the rules governing foreign lawyers in Japan.

22-24 Top American and Japanese business executives hear warnings about the state of U.S.-Japan trade relations during the 22nd annual Japan-U.S. Businessmen's Conference in Minneapolis.

23 Toyota announces that it will start producing compact cars at a yet-to-be-selected site in the United States in 1988. Japan's biggest motor vehicle manufacturer is the last major Japanese auto maker to unveil plans for U.S. production.

26 The Nakasone cabinet approves austere guidelines for the fiscal 1986 general account budget, limiting the growth of total spending to 1.5 percent.

30 The long-awaited "action program" for improving foreign access to Japanese markets is announced. Reform of Japan's standards and approval processes is billed as the centerpiece of the package, which also outlines changes in tariffs, import quotas, government procurement, financial and capital markets, services and import promotion measures. In most areas the list of measures goes beyond the statements of principles that normally constitute Japan's liberalization initiatives to detail the specific steps that will be taken. The package contains a timetable for change spanning the next three years — another first. Perhaps most importantly, Prime Minister Nakasone pledges that implementation of the program will be overseen at the highest political levels to prevent bureaucratic footdragging.

August 1985

6 Ruling for environmentalists and against the Department of Commerce and Japanese fishing interests, a U.S. appeals court decides that Japan's

failure to end whaling hinders the effectiveness of international fishing agreements and justifies penalties as prescribed under U.S. law.

6 It is disclosed that the Justice Department has opened an antitrust investigation of charges of possible predatory pricing of EPROMs (erasable programmable read-only memories) and other semiconductor devices by Hitachi, Ltd.

7 A congressional delegation headed by Rep. Sam Gibbons (D, Fla.) tells Prime Minister Nakasone that Japan should reduce its trade surplus with the United States to $15 billion by 1990.

7 JDA releases its annual white paper, which identifies the Soviet military buildup as the main threat to Japanese and global security. Separately, Prime Minister Nakasone expresses caution about revising or eliminating the ceiling on defense spending.

8 In a preliminary ruling, the ITC finds a reasonable indication that American semiconductor producers are being injured by imports of 64K DRAMs from Japan allegedly sold at less than fair value.

12-13 USTR Yeutter, during his first official overseas trip, says in Tokyo that he opposes export restraints as a means to reduce Japan's enormous trade surplus with the United States; instead, he tells Prime Minister Nakasone, Washington wants Japan to purchase more American goods. He praises the "action program" but cautions that "implementation is the key." Mr. Yeutter and MITI Minister Murata agree to establish a new forum separate from the MOSS negotiations on electronics to discuss the growing problems in bilateral semiconductor trade.

13 Sanko Steamship Co., Ltd., the world's largest oil tanker operator, files for bankruptcy — the largest corporate failure in postwar Japan. Toshio Komoto, head of his own 35-member LDP faction and former president of the company, resigns from the cabinet.

15 EPA releases its annual white paper on the economy, which states that Japan's future growth will be based on the information and high technology sectors.

19 Visiting Tokyo, Senate Majority Leader Robert Dole (R, Kan.) calls for "prompt and dramatic" market opening measures to contain the protectionist backlash brewing in Congress.

28 The Tokyo Stock Exchange announces that it will increase its membership by 10 seats, opening the way for foreign securities firms to participate in the world's second-largest equity market.

28 President Reagan rejects an ITC recommendation to impose quotas or higher tariffs on expanding shoe imports, which the commission had found were a substantial cause of serious injury to American producers in a 201 proceeding. The decision reignites congressional complaints that the administration is unresponsive to the needs of domestic manufacturers.

September 1985

5 The Japan Federation of Bar Associations unveils a compromise proposal to give foreign lawyers more freedom to advise Japanese clients on non-Japanese law. The draft, however, still contains a number of limitations and qualifications that make it unacceptable to the United States.

6 Following intense debate among top LDP officials and key cabinet ministers, Prime Minister Nakasone pledges that Japan will retain its policy limiting defense spending to 1 percent of GNP, but says that JDA's five-year defense estimates will be elevated to the status of an official government plan. The action, effective with the buildup program for FY 1986-FY 1990, is an attempt to give JDA greater leverage in budget negotiations.

6 Micron Technology files a $300 million damage suit against its six major Japanese competitors with the U.S. district court in Boise, Idaho, charging them with conspiring to monopolize the DRAM market and drive U.S. suppliers out of business.

7 Confronted by a Congress seemingly intent on passing some form of protectionist legislation, the White House goes on the offensive. President Reagan puts U.S. trading partners on notice that Washington will not tolerate barriers to American exports. In a pair of unprecedented steps, Mr. Reagan initiates investigations under Section 301 of the 1974 Trade Act of restrictions allegedly maintained by Japan (cigarettes), Korea (life insurance) and Brazil (data processing equipment) that block access for U.S. goods and services and sets a December 1 deadline for resolution of two long-running unfair trade practices cases involving Japan (leather and leather footwear) and the EC (canned fruit). Congressmen from both parties declare the moves inadequate.

12 A key government advisory council recommends that Japan lift its ban on imports of gasoline, kerosene and light fuel oils.

17 President Reagan begins his first press conference in three months with a statement on the importance of "free and fair trade" and a plea to Congress not to move ahead with protectionist legislation.

17 The Senate Finance Committee approves Sen. Danforth's telecommunications trade bill, which would require retaliation against Japan and other countries found to be closed to

American-made telecommunications equipment.

18 The Japanese cabinet approves a new five-year defense buildup program for the FY 1986-FY 1990 period. While defense spending will be slightly less than JDA sought, it could breach the 1 percent of GNP ceiling. The program will assume the status of an official government plan if approved by the Diet, unlike its predecessors, which were considered merely planning documents.

18 Japan officially decides to increase its foreign aid over the 1986-92 period to more than $40 billion.

18 Like Finance Minister Takeshita, Bank of Japan governor Sumita criticizes proposals to curb capital outflows to prop up the yen, saying such restraints could not only destabilize exchange markets but also adversely affect U.S. capital markets.

21 The Government Tax System Advisory Council, made up of business executives and government officials, is inaugurated to explore tax reform options. The package is expected to include both tax reductions to stimulate domestic demand and tax increases to meet the government's austerity criterion.

22 With the dollar showing renewed strength against major foreign currencies, finance ministers and central bank chiefs from the United States, Japan, Britain, West Germany and France agree at a New York meeting to coordinate efforts to reduce the dollar's value. They also make it clear that they are prepared to intervene aggressively in exchange markets — a major policy shift for the Reagan administration, which was the moving force behind the meeting.

23 President Reagan unveils his long-awaited trade policy. It features a $300 million "war chest" to fight other countries' export subsidies and a crackdown on unfair foreign trade practices through more aggressive application of existing trade laws and the formation of an interagency "strike force" to pinpoint unfair trade practices and develop and implement strategies to combat them. Congressional reaction to the speech is mixed at best, but Japanese officials express support for the measures.

26 Foreign Minister Abe, in an address to the U.N. General Assembly, signals the government's willingness to assume wider responsibilities in international politics in areas where Japan can play a productive, noncontroversial role.

26 Secretary of State Shultz and Foreign Minister Abe agree to try to resolve all outstanding issues connected with the MOSS negotiations on telecommunications equipment and services, medical equipment and pharmaceuticals, electronics and forest products by the end of 1985.

30 Semiconductor trade complaints against Japan multiply as three major U.S. manufacturers charge that eight Japanese suppliers are not only selling all densities of EPROMs in the United States for less than in Japan but also marketing them at prices well below production costs.

30 The yen climbs to ¥217=$1.00, its highest level since early December 1981. The Japanese currency had been moving up against the dollar since mid-year but had reversed course at the beginning of September. By September 20, the last trading day before the Group of Five nations pledged cooperation to lower the dollar's value, the yen was back down to ¥241.7.

30 Faltering exports and sluggish domestic demand again slow the pace of Japanese economic activity in the third quarter. Inflation-adjusted GNP figures indicate the economy is only growing at an annual rate of 2.7 percent.

30 Japan's trade surplus jumps to $30.3 billion in the January-September 1985 period from $22.3 billion the year before as the slowdown in exports is more than offset by a drop in imports. The U.S. trade deficit with Japan also shows no signs of a slowdown, going up from $28.4 billion to $36.9 billion

October 1985

1 MOF liberalizes interest rates on large time deposits.

2 GATT members agree to begin preparations for a new round of multilateral trade negotiations. The controversy over whether to include trade in services under the GATT framework, which held up agreement on a new round, is put aside for future discussion.

7 Chrysler and Mitsubishi Motors select Bloomington-Normal, Illinois as the site of their joint car manufacturing venture.

7-8 At the annual World Bank/International Monetary Fund meetings in Seoul, Treasury Secretary Baker proposes that commercial banks in the United States, Japan and Europe provide $20 billion in loans to debtor developing countries, a 29 percent increase in lending. Finance Minister Takeshita endorses the plan.

8-10 LDP vice president Nikaido leads a nine-member delegation to Washington to try to douse the growing protectionist fires. During meetings with Vice President Bush, Secretary of State George Shultz, Commerce Secretary Baldrige and congressional leaders, Mr. Nikaido outlines a six-point party plan covering accelerated implementation of recently announced market opening measures; a new domestic demand stimulus package; emergency import measures; increased foreign aid; expanded Japanese investment in the United States; and Japanese purchases

of U.S. grain for African aid. The plan receives a polite but lukewarm response.

9 The Japanese government announces several new sanctions against South Africa to protest Pretoria's apartheid policy.

10 By a 262-159 vote, the House of Representatives passes a bill that would drastically restrict the growth of textile-apparel imports.

11 The Nakasone cabinet drafts guidelines for the reorganization of JNR. The government-owned rail corporation announces plans to cut its work force by almost one-third by April 1, 1987.

14 A special session of the Diet convenes to tackle problems left over from the regular session. Foremost among them is the need to restructure lower house election districts to reduce disparities in proportional representation.

14-15 Another round of MOSS talks on wireless telecommunications equipment makes clear that negotiators for Japan and the United States are having trouble duplicating their highly successful work on cable-based equipment. The basic problem is that MPT officials are unsure how to approach deregulation of this market since communications via radio waves were not covered by the reform proposal that served as the blueprint for change in the cable-based telecommunications market.

15 The cabinet endorses a plan to boost faltering domestic demand and, by extension, expand imports. The package includes measures to spur housing starts and consumer spending on durables. It also calls on utilities to expand capital spending. There is some provision for public works projects funded by Tokyo, but local governments are targeted for most of the increase in public investment. Critics charge that the program will have only a modest impact on demand — a point government officials implicitly concede.

16 The White House announces that it is self-initiating two more proceedings against key American trading partners — the EC (export subsidies on wheat) and Korea (lack of protection for intellectual property rights).

23 Prime Minister Nakasone, in an address to the U.N. General Assembly, appeals for international peace and underscores Japan's willingness to assume its share of international political responsibilities. The premier also calls on the two superpowers to reduce the likelihood of nuclear war.

25 Under pressure from the United States and Europe, MITI agrees to lift the ban on imports of gasoline, kerosene and light fuel oils effective January 1, 1986.

25 Prime Minister Nakasone and President Reagan, during a brief meeting in New York City, reaffirm their support for free trade and criticize the protectionism brewing in the United States. The Japanese premier promises that his government will move as quickly as possible to implement its latest package of market access initiatives and that it will cooperate in resolving other trade issues. The yen's upward movement against the dollar is also praised by both men in an attempt to jawbone exchange markets.

29 President Reagan sets in motion procedures that will allow some Alaskan crude oil to be exported to Japan.

30 In response to a congressional mandate, the Office of the USTR submits its first annual report on foreign trade barriers. The document catalogues trade barriers imposed by 34 nations that are considered "significant." The largest amount of space is devoted to Japan — not a surprising result given all the work that has been done within the U.S. government on this subject.

31 A new advisory committee appointed by Prime Minister Nakasone to report on policies Japan should pursue to harmonize its economic relations with other countries holds its inaugural meeting. The 17-member panel, chaired by former Bank of Japan governor Maekawa, consists of academic, business and government leaders. It is expected to work out specific policy proposals by March 1986.

November 1985

8 President Reagan signals that the administration will support legislation to prohibit states from using the worldwide unitary tax method to compute corporate tax liability.

13 The Senate passes by 60-39 its version of a textile-apparel rollback bill.

14 In testimony before the Senate Finance Committee devoted mainly to a defense of the administration's trade policy, USTR Yeutter says that progress in sectoral negotiations with Japan is "somewhat disappointing," adding that the United States may have to reassess its negotiating approach.

14 The ITC finds a reasonable indication that American semiconductor manufacturers are being injured by imports of EPROMs from Japan allegedly sold at less than fair value.

16 At a ministerial-level meeting in Tokyo, EC officials press Japan to adopt specific goals for imports from the EC to rectify the widening bilateral trade deficit and hasten the pace of deregulation. The Japanese delegation not only rejects EC demands for import goals but goes on the offensive, denouncing continu-

ing moves by the Community to restrain imports from Japan.

20 In an attempt to settle the complaints of dumping by Japanese manufacturers of 64K DRAMs and EPROMs and the unfair trade practices investigation triggered by the Semiconductor Industry Association, Japanese trade negotiators at subcabinet-level discussions in Tokyo offer to set floor prices under U.S.-bound DRAM and EPROM shipments and to urge major Japanese electronics companies to expand purchases of American-made chips. The American delegation reacts coolly to the proposal.

22-26 During subcabinet-level MOSS talks on telecommunications equipment in Tokyo, Japanese negotiators unexpectedly offer concessions on mobile telephones, paging devices and other communications products that operate on radio waves. Tokyo opens the door for self-certification of wireless equipment by American exporters and agrees to reduce the number of technical standards and requirements radio-operated communications equipment must meet.

23 By voice vote, the Senate passes the Japanese Technical Literature Act, a bill designed to facilitate the transfer of technical information between American and Japanese private-sector and government sources.

25 The Finance Ministry decides on a FY 1985 supplementary budget that would raise overall spending by 5 percent.

28 Prime Minister Nakasone signals that Japan plans to seek rapprochement with the Soviet Union, saying that the Reagan-Gorbachev summit in Geneva has provided the chance to improve Soviet-Japan relations. Mr. Nakasone nonetheless reiterates his government's firm stand on the reversion of the four islands off Hokkaido, now held by the Soviets, to Japan.

28 Six foreign securities firms, including three headquartered in the United States, gain membership on the Tokyo Stock Exchange, marking a major step in the liberalization of Japan's financial markets.

28 GATT members agree to convene a preparatory committee to plan an agenda for a new round of multilateral trade negotiations.

December 1985

1 The Reagan administration's deadline for resolution of its long-running dispute with Tokyo on Japanese import quotas on leather and leather footwear passes, with trade negotiators deadlocked despite more than a week of discussions. Japan's offer to replace its quantitative limits with tariff quotas is rejected out-of-hand by American trade officials, who maintain that the proposed system is no less restrictive than the present one.

2 In a preliminary ruling, the Commerce Department calculates dumping margins ranging from 8.9 percent to 94 percent on sales of 64K DRAMs by four Japanese suppliers.

2 Foreign Minister Abe says that Tokyo is prepared to conclude the MOSS negotiations by the year-end deadline. Almost all the demands made by the United States to improve market opportunities in Japan for American suppliers of telecommunications equipment and services, medical equipment and pharmaceuticals and electronics products have been addressed. The forest products talks remain stalled, however.

3 The House approves, 255-161, the Senate-passed version of the textile-apparel import bill, which also covers footwear and copper imports.

4 Bank of Japan governor Sumita reiterates that stabilization of the yen at a high level remains the central bank's top priority. He also rules out a near-term cut in the discount r[illegible]

5 [illegible]overnment and LDP tax councils agree to make no major changes in the tax system for FY 1986.

6 Signaling the White House's willingness to do battle for the U.S. semiconductor industry, President Reagan takes the unprecedented step of ordering a dumping investigation of 256K and higher-density DRAM chips from Japan. The decision to act on the first recommendation of the special cabinet-level "strike force" on unfair foreign trade practices follows additional bilateral discussions in late November and early December on a negotiated settlement of the three trade complaints then outstanding against Japanese semiconductor makers. These talks had convinced the administration that Tokyo, while anxious to call a truce in the escalating U.S.-Japan semiconductor war, was unlikely to offer an acceptable settlement plan.

9 The Japan Federation of Bar Associations outlines one major change in its September proposal to give foreign lawyers more freedom to work in Japan, but U.S. trade officials reject the plan as still inadequate.

9 Despite the yen's 20 percent gain against the dollar since late September, Treasury Department officials, in Tokyo to review the impact of the September 22 G-5 agreement on exchange rates, are unexpectedly critical of Tokyo's efforts to deregulate financial markets and internationalize the yen. MOF representatives counter that Japan is accelerating implementation of some parts of its deregulation plan and add that Washington's suggested pace is simply too much, too fast.

10 Although a formal decision on Japanese participation in the SDI research program had been expected by mid-October at the latest, Foreign Minister Abe says Tokyo is still undecided.

11 Toyota announces that it has selected a site near Georgetown, Kentucky for its U.S. car assembly complex.

13 The Diet approves three bills that implement parts of the July market access package effective January 1, 1986.

13 An unidentified MITI official suggests that Japan will drop its restraints on U.S.-bound car exports at the end of March 1986, giving an early start to the annual bilateral debate on this issue.

17 As promised, President Reagan vetoes legislation providing import protection for the textile-apparel, footwear and copper industries.

18 Prime Minister Nakasone calls for a cut in interest rates to stimulate domestic demand.

18 Sen. Pete Wilson (D, Calif.) introduces an administration-supported bill to ban the use of the worldwide unitary taxation method by states.

21 The special session of the Diet ends without action on electoral reform and anti-espionage legislation.

21 Washington and Tokyo work out an agreement that ends their dispute over Japanese restrictions on imports of leather and leather footwear. The compromise deal allows Japan to continue to protect manufacturers of leather and leather products, although through tariff quotas rather than straight import quotas. It also provides for $236 million in Japanese trade concessions as compensation to American exporters and the withdrawal of $24 million worth of U.S. concessions on leather imports from Japan.

21-23 With the agreement that has regulated Japanese textile and apparel exports to this country for the last four years set to expire December 31, trade negotiators for the United States and Japan meet in Tokyo to discuss the terms of a new pact. The initial round of discussions reveals deep differences between the two countries.

23 The Japanese government's economic outlook for FY 1986 envisages a 4 percent real growth rate despite the adverse effects of a strong yen. The external sector is expected to have a negative impact on growth for the first time since FY 1978, but domestic demand, fueled by stepped-up consumer spending and investment, is projected to expand by an inflation-adjusted 4.2 percent. FY 1986 GNP forecasts by private economists are less optimistic, falling between 2.5 percent and 3.5 percent.

27 Prime Minister Nakasone reshuffles his cabinet. Key officials — including Foreign Minister Abe, Finance Minister Takeshita and JDA director general Kato — retain their positions, while new faces are named to the MITI, MPT, Agriculture and cabinet secretary positions.

28 The cabinet approves a draft budget for FY 1986 that provides for a 3 percent rise in overall general account spending but a small cut in discretionary expenditures. Defense and foreign aid are again among the few exceptions to the lid on discretionary expenditures.

31 The yen closes out 1985 at ¥200.5=$1.00, its highest daily median rate since January 22, 1981 and 31.4 percent above its February 13, 1985 low. Nearly two-thirds of this appreciation occurred after the September 22 agreement by the Group of Five nations to lower the value of the dollar.

31 Thanks to an impressive fourth quarter rebound, the Japanese economy turns in a better-than-expected performance in 1985, expanding 4.5 percent in inflation-adjusted terms. Continued strong growth in capital spending in the October-December period plus a recovery in housing construction more than offset the drag of another quarterly decline in exports and push real GNP growth in the last three months of 1985 to 5.8 percent at an annual rate.

31 Although the external sector was a drag on Japan's economic growth for much of 1985, this fact is not obvious in the country's year-end trade figures. Exports top imports by a huge $46.1 billion, easily breaking 1984's then-record surplus of $33.6 billion. Similarly, the U.S. trade deficit with Japan hits another all-time high in 1985, jumping to $49.8 billion from $36.8 billion the year before.

Appendix B

Statistical Tables

Table 1: Japan's Gross National Product at 1980 Constant Prices, 1981-1985

Table 2: Major Interest Rates in Japan, 1981-1985

Table 3: Money Supply in Japan, 1981-1985

Table 4: Japan's General Account Expenditures (Revised), FY 1981-FY 1985

Table 5: Japan's Discretionary General Account Spending (Revised), FY 1981-FY 1985

Table 6: Japan's General Account Revenues (Revised), FY 1981-FY 1985

Table 7: Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays (Initial), FY 1981-FY 1985

Table 8: Japan's Industrial Production Index by Sector, 1981-1985

Table 9: Japan's Index of Industrial Production by End-Use Classification, 1981-1985

Table 10: Japan's Index of Producers' Inventories of Finished Goods, 1981-1985

Table 11: Japan's Index of Consumption of Materials, 1981-1985

Table 12: Japan's Index of Inventories of Materials, 1981-1985

Table 13: Japan's Index of Manufacturing Operating Rates, 1981-1985

Table 14: Residential Construction Starts in Japan, 1981-1985

Table 15: Japan's Labor Force Survey, 1981-1985

Table 16: Employment Indexes of Regular Workers in Japan, 1981-1985

Table 17: Nominal Wage Indexes of Regular Workers in Japan, 1981-1985

Table 18: Average Monthly Wages of Manufacturing Employees in Japan by Industry, 1981-1985

Table 19: Indexes of Labor Productivity in Japan, 1981-1985
Table 20: Japan's Consumer Price Index, 1981-1985
Table 21: Japan's Wholesale Price Index by Industry, 1981-1985
Table 22: Japan's Wholesale Price Index by End-Use Classification, 1981-1985
Table 23: Japan's Global Balance of Payments, 1981-1985
Table 24: Japan's Balance of Payments with the United States, 1981-1985
Table 25: Japan's Exports and Imports in Dollar Terms, 1981-1985
Table 26: Japan's Exports and Imports in Yen Terms, 1981-1985
Table 24: Japan's Balance of Payments with the United States, 1981-1985
Table 25: Japan's Exports and Imports in Dollar Terms, 1981-1985
Table 26: Japan's Exports and Imports in Yen Terms, 1981-1985
Table 27: Japan's Export and Import Volume Indexes, 1981-1985
Table 28: Japan's Export and Import Yen-Based Price Indexes, 1981-1985
Table 29: Japan's Exports by Major Market, 1981-1985
Table 30: Japan's Imports by Major Supplier, 1981-1985
Table 31: Japan's Trade Balance with Major Trading Partners, 1981-1985
Table 32: Japan's Exports by Commodity, 1981-1985
Table 33: Japan's Imports by Commodity, 1981-1985
Table 34: Japan's Dollar-Based Trade with the United States, 1981-1985
Table 35: Japan's Yen-Based Trade with the United States, 1981-1985
Table 36: Yen-Dollar Exchange Rate Used to Convert Customs Clearance Trade Data, 1981-1985
Table 37: Yen-Dollar Exchange Rate on Tokyo Foreign Exchange Market, 1981-1985
Table 38: Japan's Foreign Direct Investment by Country, FY 1981-FY 1985
Table 39: Japan's Foreign Direct Investment by Industry, FY 1981-FY 1985
Table 40: U.S. International Transactions, 1981-1985
Table 41: U.S. Current Account Balance with Japan, 1981-1985
Table 42: U.S. Exports and Imports, 1981-1985
Table 43: U.S. Exports by Major Market, 1981-1985
Table 44: U.S. Imports by Major Supplier, 1981-1985
Table 45: U.S. Trade Balance with Major Trading Partners, 1981-1985
Table 46: U.S. Exports by Commodity, 1981-1985
Table 47: U.S. Imports by Commodity, 1981-1985

Table 48: U.S. Trade with Japan, 1981-1985

Table 49: U.S. Exports to Japan by Commodity, 1981-1985

Table 50: U.S. Imports from Japan by Commodity, 1981-1985

Table 51: U.S. Exports to Japan by End-Use Classification, 1984-1985

Table 52: U.S. Imports from Japan by End-Use Classification, 1984-1985

Table 53: U.S. Direct Investment Position Abroad, Year-End 1981-1985

Table 54: U.S. Direct Investment Position in Japan, Year-End 1981-1985

Table 55: Foreign Direct Investment Position in the United States, Year-End 1981-1985

Table 56: Japan's Foreign Direct Investment Position in the United States, Year-End 1981-1985

Table 1: Japan's Gross National Product at 1980 Constant Prices, 1981-1985

(in billions of yen, seasonally adjusted, quarterly figures at annual rates)

	1981	1982	1983	1984	1985
Gross National Product	¥248,725.9 (3.7%)	¥256,395.2 (3.1%)	¥264,703.7 (3.2%)	¥278,118.6 (5.1%)	¥290,683.4 (4.5%)
Personal Consumption Spending	145,071.7 (1.3%)	148,971.0 (4.1%)	153,781.5 (3.2%)	158,124.5 (2.8%)	162,445.0 (2.7%)
Private Residential Construction	14,946.2 (-2.5%)	14,837.2 (-0.7%)	13,917.2 (-6.2%)	13,619.1 (-2.1%)	14,056.6 (3.2%)
Private Fixed Nonresidential Investment	39,647.3 (5.4%)	40,618.7 (2.5%)	41,720.7 (2.7%)	46,277.4 (10.9%)	51,794.0 (11.9%)
Change in Business Inventories	1,720.1 (-9.1%)	1,725.1 (0.3%)	795.8 (-53.9%)	1,609.6 (102.3%)	1,801.8 (11.9%)
Government Current Expenditures	24,620.3 (4.8%)	25,099.1 (1.9%)	25,838.2 (2.9%)	26,471.3 (2.5%)	27,153.7 (2.6%)
Government Fixed Investment	23,670.3 (3.0%)	23,437.7 (-1.0%)	23,052.2 (-1.6%)	22,374.4 (-2.9%)	20,833.7 (-6.9%)
Change in Government Inventories	-240.9 (*)	-387.9 (*)	-352.8 (*)	162.8 (*)	305.9 (87.9%)
Net External Sector	1,291.0 (*)	2,094.3 (62.2%)	5,950.8 (184.1%)	9,479.7 (59.3%)	12,294.7 (29.7%)
Exports of Goods and Services and Factor Income Received	41,287.0 (15.6%)	42,779.0 (3.6%)	44,555.6 (4.2%)	52,365.0 (17.5%)	55,463.4 (5.9%)
Imports of Goods and Services and Factor Income Paid	39,996.0 (5.1%)	40,684.7 (1.7%)	38,604.8 (-5.1%)	42,885.3 (11.1%)	43,168.8 (0.7%)

(continued)

Table 1: Japan's Gross National Product at 1980 Constant Prices, 1981-1985 (continued)

(in billions of yen, seasonally adjusted, quarterly figures at annual rates)

	January-March 1984	April-June 1984	July-September 1984	October-December 1984	January-March 1985	April-June 1985	July-September 1985	October-December 1985
Gross National Product	¥273,231.8 (6.7%)	¥276,377.2 (4.7%)	¥278,228.4 (2.7%)	¥284,215.8 (8.9%)	¥285,425.7 (1.7%)	¥289,437.3 (5.7%)	¥291,379.9 (2.7%)	¥295,529.9 (5.8%)
Personal Consumption Spending	157,131.4 (4.1%)	157,557.2 (1.1%)	158,375.9 (2.1%)	159,240.8 (2.2%)	161,106.4 (4.8%)	161,900.4 (2.0%)	162,778.8 (2.2%)	163,661.5 (2.2%)
Private Residential Construction	13,613.2 (-6.6%)	13,500.5 (-3.3%)	13,624.8 (3.7%)	13,742.5 (3.5%)	13,913.9 (5.1%)	14,227.9 (9.3%)	13,881.0 (-10.1%)	14,188.1 (9.2%)
Private Fixed Nonresidential Investment	44,371.5 (12.8%)	45,512.3 (10.7%)	46,575.3 (9.7%)	48,452.9 (17.1%)	48,574.5 (1.0%)	51,114.2 (22.6%)	52,981.2 (15.4%)	54,303.4 (10.4%)
Change in Business Inventories	1,162.1 (-112.1%)	1,356.5 (85.7%)	1,957.3 (333.5%)	1,950.7 (-1.4%)	2,112.0 (37.4%)	1,825.3 (-66.4%)	1,438.2 (-115.8%)	1,838.1 (167.0%)
Government Current Expenditures	26,250.6 (4.3%)	26,429.6 (2.8%)	26,538.4 (1.7%)	26,675.0 (2.1%)	26,979.1 (4.6%)	27,081.5 (1.5%)	27,192.9 (1.7%)	27,369.9 (2.6%)
Government Fixed Investment	22,395.2 (-6.4%)	22,694.8 (5.5%)	22,507.2 (-3.3%)	22,014.9 (-9.0%)	21,615.5 (-7.5%)	19,954.0 (-34.5%)	20,495.6 (11.3%)	20,924.9 (8.6%)
Change in Government Inventories	73.8 (*)	-38.7 (*)	594.0 (*)	42.6 (*)	27.9 (*)	77.6 (*)	515.6 (*)	604.4 (*)
Net External Sector	8,234.0 (146.2%)	9,365.0 (67.3%)	8,055.5 (-68.8%)	12,096.4 (408.5%)	11,096.4 (-37.4%)	13,256.4 (103.7%)	12,097.6 (-39.8%)	12,639.5 (19.2%)
Exports of Goods and Services and Factor Income Received	49,638.7 (21.4%)	51,680.7 (17.5%)	52,691.0 (8.1%)	55,256.5 (20.9%)	54,833.7 (-3.1%)	57,176.9 (18.2%)	55,077.6 (-15.5%)	54,720.5 (-2.6%)
Imports of Goods and Services and Factor Income Paid	41,404.7 (6.9%)	42,315.7 (9.1%)	44,635.5 (23.8%)	43,160.1 (-13.9%)	43,737.3 (5.5%)	43,920.5 (1.7%)	42,980.0 (-8.8%)	42,081.2 (-8.6%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

Table 2: Major Interest Rates in Japan, 1981-1985

(percent per annum)

	Central Bank Discount Rate*	Long-Term Prime Lending Rate*	Call Rate**	Average Interest Rate on Loans and Discounts of All Banks*	Savings Deposits*			
					Commercial Banks		Post Office	
					Ordinary Deposits	Six-Month Time Deposits	Ordinary Deposits	One-Year Savings Certificates
1981	5.5%	8.6%	7.43%	7.56%	2.25%	5.5%	3.6%	4.75%
1982	5.5	8.6	6.94	7.15	1.75	5.0	3.12	4.25
1983	5.0	8.2	6.39	6.81	1.75	5.0	3.12	4.25
1984	5.0	7.6	6.10	6.57	1.50	4.75	2.88	4.0
1985	5.0	7.2	6.46	6.47	1.50	4.75	2.88	4.0

*End of period.
**Average for period.

Source: Bank of Japan

Table 3: Money Supply in Japan, 1981-1985

(in billions of yen, average for period)

	Outstanding Money Supply (M_2+CDs)*	Change Over Year-Earlier Period
1981	¥215,527	8.9%
1982	235,336	9.2
1983	252,640	7.4
1984	272,360	7.8
1985	295,183	8.4

*Includes currency in circulation, demand deposits and time deposits (excluding trust accounts) held by commercial banks, plus certificates of deposit.

Source: Bank of Japan

Table 4: Japan's General Account Expenditures (Revised), FY 1981-FY 1985*

(in billions of yen and percentage change)

	FY 1981		FY 1982		FY 1983		FY 1984		FY 1985	
Total Expenditures	Y47,125.4	7.9%	Y47,562.1	0.9%	Y50,839.4	6.9%	Y51,513.4	1.3%	Y53,222.9	3.3%
Social Security	8,867.6	7.3	9,141.6	3.1	9,231.3	1.0	9,683.9	4.9	9,830.8	1.5
Public Assistance	992.3	3.8	1,080.6	8.9	1,129.7	4.6	1,187.5	5.1	1,082.2	-8.9
Social Welfare	1,508.2	8.6	1,603.6	6.3	1,917.5	19.6	2,013.2	5.0	2,056.2	2.1
Social Insurance	5,566.8	8.5	5,658.2	1.6	5,378.9	-4.9	5,619.1	4.5	5,847.5	4.1
Health Services	418.3	2.0	425.6	1.7	435.4	2.3	485.8	11.6	464.4	-4.4
Unemployment Compensation	382.1	0.8	373.7	-2.2	369.8	-1.1	378.3	2.3	380.5	0.6
Education and Science	4,821.6	4.8	4,832.6	0.2	4,834.3	0.0	4,920.3	1.8	4,904.3	-0.3
Compulsory Education	2,168.4	7.1	2,220.5	2.4	2,254.5	1.5	2,368.8	5.1	2,415.2	2.0
Transfer to School Account	1,014.3	3.4	1,015.5	0.1	1,015.6	0.0	1,096.9	8.0	1,075.1	-2.0
Science and Technology Promotion	370.7	5.4	381.8	3.0	392.0	2.7	374.6	-4.4	375.4	0.2
School Facilities	583.0	-6.3	528.8	-9.3	489.8	-7.4	427.3	-12.8	385.5	-9.8
School Aid	594.5	9.8	595.2	0.1	592.0	-0.5	566.6	-4.3	569.6	0.5
Student Loans	90.6	12.6	90.8	0.2	90.3	-0.5	86.2	-4.6	83.6	-3.0
National Debt Service	6,654.2	21.2	6,906.9	3.8	8,167.5	18.3	9,232.7	13.0	10,180.5	10.3
Pensions	1,803.0	9.9	1,891.7	4.9	1,890.0	-0.1	1,885.8	-0.2	1,863.7	-1.2
Civil Servants	136.1	4.1	135.4	-0.5	132.7	-2.0	128.2	-3.4	124.8	2.8
Veterans	1,508.5	11.5	1,590.1	5.4	1,603.6	0.9	1,601.1	-0.2	1,578.7	-1.4
Other Pensions	148.4	1.0	155.9	5.0	143.1	-8.2	146.0	2.0	149.9	2.7
Administrative Costs	10.0	6.5	10.3	3.4	10.6	2.3	10.5	-0.9	10.4	-1.4
Local Finance	8,722.6	11.4	7,976.4	-8.6	7,672.9	-3.8	9,219.0	20.2	9,690.1	5.1
Local Allocation Tax	8,039.6	15.6	7,535.2	-6.3	7,315.1	-2.9	9,036.1	23.5	9,690.1	7.2
Interest Support and Special Grants	683.1	-22.1	441.1	-20.2	357.8	-18.9	182.9	-48.6	0.0	-100.0
Defense	2,429.1	7.2	2,566.6	3.0	2,761.0	7.6	2,961.5	7.3	3,169.7	7.0
Public Works	7,001.2	2.9	7,281.3	4.0	7,224.3	-0.8	6,882.0	-4.7	6,922.3	0.6
Erosion and Flood Control	1,107.5	0.2	1,106.4	-0.1	1,107.4	0.1	1,098.4	-0.8	1,082.8	-1.4
Road Improvement	1,901.8	-0.9	1,891.9	-0.5	1,893.3	0.1	1,899.9	0.3	1,856.1	-2.3
Harbors and Airports	523.6	-0.9	522.6	-0.2	524.1	0.3	519.8	-0.8	511.9	-1.5
Housing	843.0	5.1	877.9	4.1	894.3	1.9	913.9	2.2	927.9	1.5
Social Infrastructure	985.8	2.0	987.2	0.1	988.2	0.1	980.3	-0.8	970.3	-1.0
Agricultural Infrastructure	900.0	0.2	899.2	-0.1	900.0	0.1	892.1	-0.9	879.0	-1.5
Forestry and Industrial Water Supplies	180.7	0.2	178.4	-1.2	177.1	-0.7	173.2	-2.2	169.6	-2.1
Disaster Reconstruction	547.2	41.2	806.1	47.2	728.4	-9.6	393.5	-46.0	514.0	30.6
Reserves	11.8	-10.0	11.7	-0.3	11.4	-3.1	10.9	-3.7	10.7	-2.2
Economic Cooperation	425.1	11.3	474.9	11.7	498.2	4.9	540.9	8.6	581.2	7.5
Small Business Assistance	248.1	2.2	244.3	-1.5	238.9	-2.2	230.4	-3.6	211.9	-8.0
Energy Support	496.3	16.8	559.3	12.7	557.4	-0.3	610.4	9.5	626.2	2.6
Food Agency Account	1,014.1	6.1	1,005.5	-0.9	917.2	-8.8	808.6	-11.8	695.2	-14.0
Miscellaneous	4,478.3	1.0	4,451.0	-0.6	6,636.4	49.1	4,367.9	-34.2	4,347.0	-0.5
Reserves	164.2	-53.1	230.0	40.1	210.0	-8.7	170.0	-19.0	200.0	17.6

*Revised budget figures include the supplementary budget.

Source: Ministry of Finance

Table 5: Japan's Discretionary General Account Spending (Revised), FY 1981-FY 1985*

(in billions of yen and percentage change)

	FY 1981		FY 1982		FY 1983		FY 1984		FY 1985	
Total Expenditures	¥47,125.4	7.9%	¥47,562.1	0.9%	¥50,839.4	6.9%	¥51,513.4	1.3%	¥53,222.9	3.3%
Minus										
Debt Service and Transfers to Local Governments	14,693.8	18.1	14,442.2	-1.7	15,482.7	7.2	18,268.9	18.0	19,870.6	8.8
Equals										
Discretionary Spending	32,431.6	3.8	33,120.0	2.1	35,356.8	6.8	33,244.5	-6.0	33,352.3	0.3

*Revised budget figures include the supplemental budget.

Source: Ministry of Finance

Table 6: Japan's General Account Revenues (Revised), FY 1981-FY 1985*

(in billions of yen and percentage change)

	FY 1981		FY 1982		FY 1983		FY 1984		FY 1985	
Total Revenues	¥47,125.4	7.9%	¥47,562.1	1.7%	¥50,839.4	6.9%	¥51,513.4	1.3%	¥53,222.9	3.3%
Tax and Stamp Revenues	31,831.6	17.3	30,478.0	-4.3	31,902.0	4.7	34,835.0	9.2	38,145.0	9.5
Direct Taxes	23,811.6	17.8	22,524.0	-5.4	23,835.0	5.8	26,193.0	9.9	28,579.0	9.1
Income Taxes	12,941.6	17.5	12,769.0	-1.3	13,545.0	6.1	13,985.0	3.2	15,378.0	10.0
Corporate Taxes	10,352.0	18.3	9,056.0	-12.5	9,497.0	4.9	11,333.0	19.3	12,197.0	7.6
Indirect Taxes	8,020.0	15.6	7,954.0	-0.8	8,067.0	1.4	8,642.0	7.1	9,560.0	10.6
Liquor Taxes	1,830.0	28.2	1,767.0	-3.4	1,860.0	5.3	1,992.0	7.1	1,955.0	-1.9
Gasoline Taxes	1,521.0	1.0	1,624.0	6.8	1,601.0	-1.4	1,617.0	1.0	1,554.0	-3.9
Commodity Taxes	1,272.0	11.5	1,234.0	-3.0	1,314.0	6.5	1,503.0	14.4	1,538.0	2.3
Monopoly Profits	778.8	-0.6	761.9	-2.2	1,004.2	31.8	1,024.6	2.0	6.6	-99.4
Public Enterprise Receipts	12.2	21.8	14.4	17.7	15.1	5.1	15.4	1.4	15.9	3.2
Sale of Public Properties	72.9	51.1	67.3	-7.7	82.7	22.8	92.3	11.7	157.9	71.1
Miscellaneous	1,474.6	37.0	1,854.3	25.8	3,843.3	107.3	2,282.6	-40.6	2,254.0	-1.3
Public Bonds	12,900.0	-9.6	14,345.0	11.2	13,790.0	-3.9	12,865.0	-6.7	12,438.0	-3.3
Carryover Surplus	55.2	-84.1	41.3	-25.3	202.2	390.1	398.5	97.1	205.4	-49.5

*Revised budget figures include the supplemental budget.

Source: Ministry of Finance

Table 7: Uses and Sources of Japan's Fiscal Investment and Loan Program Outlays (Initial), FY 1981-FY 1985

(in billions of yen and percentage change)

	FY 1981		FY 1982		FY 1983		FY 1984		FY 1985	
Total Outlays	¥19,489.7	7.2%	¥20,288.8	4.1%	¥20,702.9	2.0%	¥21,106.6	1.9%	¥20,858.0	-1.2%
Housing	5,111.4	7.3	5,130.1	0.4	5,304.1	3.4	5,289.5	-0.3	5,289.3	-0.0
Water Works	2,716.3	5.6	2,863.2	5.4	2,764.8	-3.4	3,007.5	8.8	3,280.9	9.1
Welfare	658.4	4.8	701.3	6.5	652.0	-7.0	637.9	-2.1	595.7	-6.6
Education	794.3	-1.9	762.8	-3.9	783.0	2.6	777.1	-0.8	745.3	-4.1
Small Business	3,825.2	12.5	3,905.9	2.1	3,942.2	0.9	3,968.3	0.7	3,764.4	-5.1
Agriculture	916.6	3.5	906.8	-1.1	963.0	6.2	1,034.8	7.5	890.6	-13.9
Land Conservation and Disasters	276.6	-11.2	310.2	11.9	332.5	7.4	379.1	13.8	472.8	24.7
Roads	1,182.6	14.7	1,472.6	24.5	1,583.7	7.5	1,711.7	8.1	1,826.4	6.7
Transportation and Communications	1,953.8	12.0	1,949.0	-0.3	1,924.6	-1.2	1,887.6	-1.9	1,763.4	-6.6
Regional Development	455.9	-5.0	538.1	20.7	511.4	-5.0	500.0	-2.2	511.2	2.2
Industry and Technology	593.6	8.5	635.6	7.1	626.2	-1.5	620.3	-0.9	603.3	-2.7
Foreign Trade and Economic Cooperation	1,005.0	-1.4	1,113.2	10.8	1,315.4	18.2	1,292.8	-1.7	1,114.7	-13.8
Total Revenues	¥22,989.7	11.2%	¥23,788.8	3.5%	¥24,402.9	2.6%	¥24,706.6	1.2%	¥25,858.0	4.7%
Industrial Investment Special Account	18.9	11.8	18.9	0.0	5.2	-72.5	4.8	-7.7	31.4	554.2
Trust Fund Bureau Fund	19,480.2	12.0	19,568.9	0.5	19,135.3	-2.2	18,905.2	-1.2	20,029.0	5.9
Postal Savings	8,900.0	12.7	7,900.0	-11.2	7,900.0	0.0	6,900.0	-12.7	6,400.0	-7.2
Pension Contributions	3,900.0	18.2	4,300.0	10.3	4,100.0	-4.7	3,850.0	-6.1	3,950.0	2.6
Other Revenues	6,680.2	7.9	7,368.9	10.3	7,135.3	-3.2	8,155.2	14.3	9,679.0	18.7
Postal Life Insurance Fund	1,890.0	11.7	1,981.0	4.8	2,354.4	18.8	2,586.6	9.9	2,587.6	0.0
Government-Guaranteed Bonds and Borrowings	1,600.6	1.2	2,220.0	38.7	2,908.0	31.0	3,210.0	10.4	3,210.0	0.0

Source: Ministry of Finance

Table 8: Japan's Industrial Production Index by Sector, 1981-1985

(1980 = 100)

	Total								
	Index	Change Over Year-Earlier Period	Mining	Manufacturing	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery
1981	101.0	1.0%	97.1	101.0	93.6	95.8	96.4	102.2	113.9
1982	101.3	0.3	96.2	101.4	91.4	92.6	99.0	100.6	125.2
1983	104.9	3.6	95.8	104.9	89.1	95.5	94.2	99.8	149.7
1984	116.5	11.1	95.3	116.7	98.3	100.4	98.5	113.0	193.4
1985	121.9	4.6	96.3	122.0	100.4	100.1	99.2	121.1	215.0

	Transport Equipment	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Pulp, Paper and Paper Products	Textiles	Lumber and Wood Products	Foods
1981	105.8	109.4	94.1	99.8	93.8	94.4	98.4	91.2	100.6
1982	99.1	103.5	91.5	102.5	88.4	97.1	97.4	87.4	101.1
1983	94.6	110.3	92.7	108.8	85.7	102.7	96.8	84.6	103.0
1984	104.1	128.4	95.9	117.9	88.8	108.0	99.0	80.8	101.5
1985	107.9	150.2	95.5	121.7	84.5	112.8	98.3	79.2	102.1

Source: Ministry of International Trade and Industry

Table 9: Japan's Index of Industrial Production by End-Use Classification, 1981-1985

(1980 = 100)

	Final Demand Goods					
	Total	Capital Goods	Construction Materials	Consumer Goods		Producer Goods
				Durable	Nondurable	
1981	103.0	106.0	92.0	107.8	103.3	98.5
1982	104.2	106.4	90.5	110.1	106.5	97.7
1983	106.4	106.5	89.6	117.5	110.0	103.0
1984	116.6	123.3	89.8	136.9	113.0	116.5
1985	123.0	134.0	88.9	147.7	116.2	120.5

Source: Ministry of International Trade and Industry

Table 10: Japan's Index of Producers' Inventories of Finished Goods, 1981-1985

(1980 = 100)

	Total	Mining	Manufacturing	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment
1981	102.0	88.4	102.1	103.1	124.5	90.7	106.7	103.1	109.2
1982	101.4	87.9	101.5	103.9	118.3	88.4	113.6	110.6	114.2
1983	96.2	79.5	96.2	98.5	94.7	89.1	110.1	98.3	103.2
1984	99.0	92.5	99.1	101.4	100.0	87.7	118.2	104.8	103.6
1985	107.5	105.4	107.6	107.4	104.4	88.3	133.9	150.5	111.3

	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Pulp, Paper and Paper Products	Textiles	Lumber and Wood Products	Foods
1981	112.6	107.3	99.7	90.7	117.4	98.7	104.6	102.1
1982	137.9	105.6	98.1	83.0	100.4	102.6	92.1	100.4
1983	128.6	101.0	92.3	82.0	98.5	103.5	88.5	97.9
1984	125.0	99.6	99.0	79.9	107.0	101.7	92.0	103.1
1985	140.2	108.4	104.4	74.8	118.8	109.0	86.3	99.7

Source: Ministry of International Trade and Industry

Table 11: Japan's Index of Consumption of Materials, 1981-1985

(1980 = 100)

	Manufacturing	Steel	Non-ferrous Metals	Fabricated Metal Products	Machinery	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Pulp, Paper and Paper Products	Textiles	Lumber and Wood Products	Other Industries
1981	94.8	91.6	95.6	90.4	100.0	90.6	91.2	90.7	92.7	95.6	92.3	96.4
1982	91.4	89.7	91.4	93.8	95.1	83.2	89.3	84.7	94.5	94.1	88.1	94.3
1983	92.2	86.1	95.6	91.6	98.3	81.3	92.3	81.6	99.2	92.2	85.2	99.8
1984	99.6	93.4	99.1	89.6	111.5	84.0	102.5	84.6	104.2	93.7	82.2	104.3
1985	101.3	94.1	98.2	90.6	119.2	80.5	102.6	79.3	106.8	92.0	81.5	105.9

Source: Ministry of International Trade and Industry

Table 12: Japan's Index of Inventories of Materials, 1981-1985

(1980 = 100)

	Manufacturing	Steel	Non-ferrous Metals	Fabricated Metal Products	Machinery	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Pulp, Paper and Paper Products	Textiles	Lumber and Wood Products	Other Industries
1981	98.5	102.3	112.5	86.5	100.8	99.2	98.6	101.7	101.0	89.7	90.7	85.7
1982	94.9	101.1	127.5	88.2	95.1	86.7	89.7	97.8	88.8	88.9	84.7	75.4
1983	87.1	94.5	122.8	80.1	86.3	74.2	85.2	82.6	85.6	85.7	85.9	71.1
1984	86.2	86.5	118.2	75.4	94.9	73.0	90.5	83.4	87.0	85.9	80.3	69.0
1985	85.0	81.7	114.8	73.6	100.6	73.0	88.6	84.3	82.0	82.2	84.6	62.1

Source: Ministry of International Trade and Industry

Table 13: Japan's Index of Manufacturing Operating Rates, 1981-1985

(1980 = 100)

	Total	Steel	Non-ferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Nonmetallic Mineral Products	Chemicals	Petroleum and Coal Products	Pulp, Paper and Paper Products	Textiles
1981	95.4	90.4	93.0	95.8	98.0	96.2	98.8	98.2	92.5	93.1	91.0	93.4	98.6
1982	92.6	87.9	89.5	92.8	92.7	95.5	92.8	89.4	89.3	90.9	84.8	96.9	98.6
1983	94.1	85.8	92.0	90.6	92.9	101.2	92.5	92.5	88.0	93.6	85.8	102.6	98.5
1984	101.0	95.3	94.7	96.8	106.2	110.4	92.9	107.4	88.1	103.1	100.1	107.6	99.2
1985	102.2	98.2	95.1	99.7	107.2	109.9	95.0	110.9	89.9	105.6	93.4	112.5	99.4

Source: Ministry of International Trade and Industry

Table 14: Residential Construction Starts in Japan, 1981-1985

(units)

		Type of Housing		Owner-Occupant Relationship			
	Total	Public	Private	Owner-Built	Developer-Built	Rental Units	Other
1981	1,151,699	125,263	1,026,436	558,002	267,012	303,808	22,877
1982	1,146,149	102,975	1,043,174	584,182	223,641	315,448	22,878
1983	1,136,797	94,909	1,041,888	478,833	243,265	394,495	20,204
1984	1,187,282	86,285	1,100,997	469,879	231,001	464,308	22,094
1985	1,236,072	81,305	1,154,767	464,697	224,018	527,042	20,315

Source: Ministry of Construction

Table 15: Japan's Labor Force Survey, 1981-1985

(in thousands of persons)

	Working-Age Population*	Total Labor Force	Employed Labor Force	Totally Unemployed Labor Force	Unemployment Rate	Not in Labor Force	Ratio of Job Offers to Applications**
1981	90,170	57,070	55,810	1,260	2.2%	32,790	0.68
1982	91,160	57,740	56,380	1,360	2.4	33,090	0.61
1983	92,320	58,890	57,330	1,560	2.6	33,050	0.60
1984	93,470	59,270	57,660	1,610	2.7	33,730	0.65
1985	94,650	59,630	58,070	1,560	2.6	34,500	0.68

*People 15 years old and over.
**Excludes applications by new school graduates but includes those by people seeking part-time work.

Source: Prime Minister's Office and Ministry of Labor

Table 16: Employment Indexes of Regular Workers in Japan, 1981-1985

(1980 = 100)

	Total	Mining	Construction	Manufacturing	Foods and Tobacco	Textiles	Apparel	Lumber and Wood Products	Pulp and Paper Products	Publishing	Chemicals	Petroleum and Coal Products	Nonmetallic Mineral Products	Steel
1981	101.9	98.2	100.5	101.1	101.4	96.1	98.5	93.0	95.1	101.9	99.3	98.7	97.4	99.1
1982	103.1	95.7	103.1	101.8	102.5	94.1	99.3	85.8	93.2	102.6	97.4	96.6	95.1	98.0
1983	103.4	92.0	102.4	101.7	104.6	91.7	96.8	79.6	93.3	103.5	96.0	92.6	92.2	95.2
1984	104.3	89.1	101.1	103.1	104.5	89.3	94.7	74.0	92.9	104.5	95.2	89.4	90.9	92.2
1985	105.5	86.8	98.6	105.0	105.9	87.1	95.3	69.5	93.8	105.6	95.1	87.1	89.5	91.3

	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Wholesale and Retail Trade	Finance and Insurance	Real Estate	Transportation and Communications	Utilities	Services
1981	99.3	100.5	102.3	106.0	103.4	104.8	102.7	100.2	103.9	100.7	101.6	104.1
1982	98.1	102.0	104.1	110.3	104.4	106.2	104.5	100.6	103.1	100.7	102.2	106.9
1983	97.2	101.3	103.5	112.8	104.5	108.1	105.8	100.1	102.6	99.2	101.6	108.8
1984	99.5	100.8	104.5	123.2	105.0	112.0	106.3	99.9	105.7	97.8	98.8	111.3
1985	100.4	101.6	106.4	132.0	107.0	115.8	106.8	99.7	107.8	96.5	96.4	114.9

Source: Ministry of Labor

Table 17: Nominal Wage Indexes of Regular Workers in Japan, 1981-1985

(1980 = 100)

	Total	Mining	Construction	Manufacturing	Foods and Tobacco	Textiles	Apparel	Lumber and Wood Products	Pulp and Paper Products	Publishing	Chemicals	Petroleum and Coal Products	Nonmetallic Mineral Products	Steel
1981	105.3	106.1	107.2	105.6	102.8	105.4	105.6	101.5	104.0	106.2	104.7	106.3	106.7	106.4
1982	110.0	109.6	111.3	110.7	106.4	109.5	107.7	108.0	111.5	110.9	112.5	110.4	112.4	111.6
1983	113.8	114.1	115.6	115.0	111.0	113.7	110.5	112.5	117.3	116.1	117.8	115.5	116.9	113.7
1984	118.9	117.5	121.5	120.3	114.8	116.0	115.2	117.3	124.9	119.3	123.8	123.3	122.0	117.8
1985	123.2	123.0	127.0	125.1	119.2	120.1	115.7	123.7	131.8	125.9	128.3	130.9	126.9	123.7

	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments	Wholesale and Retail Trade	Finance and Insurance	Real Estate	Transportation and Communications	Utilities	Services
1981	104.5	107.1	106.9	105.0	106.1	105.2	103.0	107.3	101.1	106.5	108.3	104.2
1982	109.0	110.6	111.8	111.2	110.5	108.9	106.4	112.9	107.9	111.6	113.1	108.5
1983	114.2	114.5	113.4	117.0	114.4	115.2	109.9	118.3	111.8	116.4	116.2	110.9
1984	119.6	120.2	119.5	123.2	120.6	118.9	115.1	123.7	116.7	121.1	121.6	115.2
1985	125.4	123.9	124.4	125.6	126.4	126.4	118.6	129.7	119.2	124.3	127.2	119.3

Source: Ministry of Labor

Table 18: Average Monthly Wages of Manufacturing Employees in Japan by Industry, 1981-1985

(in thousands of yen)

	Total	Foods and Tobacco	Textiles	Pulp and Paper Products	Chemicals	Nonmetallic Mineral Products	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments
1981	¥259.7	¥217.7	¥190.0	¥251.8	¥317.5	¥247.9	¥340.0	¥291.3	¥257.1	¥292.6	¥245.5	¥297.6	¥244.9
1982	269.6	220.4	192.1	269.1	341.0	261.2	355.0	296.6	261.4	309.3	254.4	307.1	252.1
1983	279.1	226.2	198.1	283.1	357.9	272.7	359.9	309.4	269.2	313.6	267.3	316.5	265.4
1984	292.3	233.7	202.2	301.4	376.3	284.7	373.5	324.3	282.7	330.8	281.7	333.6	274.0
1985	299.5	235.5	211.9	314.6	389.6	289.0	391.7	336.4	287.8	337.6	280.7	345.1	287.1

Note: Includes overtime pay and bonuses.

Source: Ministry of Labor

Table 19: Indexes of Labor Productivity in Japan, 1981-1985

(1980 = 100)

	Total	Mining	Manufacturing	Foods	Textiles	Lumber and Wood Products	Pulp and Paper Products	Nonmetallic Mineral Products	Rubber Products	Chemicals
1981	102.4	98.1	102.4	102.4	101.8	92.8	100.2	98.4	99.2	101.8
1982	103.4	100.2	103.4	100.4	104.5	93.3	104.1	100.4	97.1	106.8
1983	108.1	104.8	108.1	99.0	107.4	96.6	111.9	105.8	107.5	115.3
1984	118.8	105.7	118.9	98.1	113.2	95.8	119.1	111.2	111.7	125.7
1985	123.8	111.3	123.9	97.3	115.3	100.7	126.6	113.1	114.0	129.7

	Petroleum and Coal Products	Steel	Nonferrous Metals	Fabricated Metal Products	Nonelectric Machinery	Electric Machinery	Transport Equipment	Precision Instruments
1981	96.4	96.8	98.2	99.3	101.7	110.3	107.5	109.5
1982	91.3	96.5	97.7	100.3	100.6	118.4	100.4	104.9
1983	92.8	97.5	103.2	98.3	101.9	136.2	96.8	114.4
1984	101.4	109.3	106.8	99.1	113.4	163.5	107.8	133.4
1985	100.8	114.1	107.8	106.1	120.3	180.1	110.8	156.2

Source: Japan Productivity Center

Table 20: Japan's Consumer Price Index, 1981-1985

(1980 = 100)

	Total										
	Index	Change Over Year-Earlier Period	Food	Housing	Utilities	Clothing	Medical Care	Transportation	Education	Recreation	Miscellaneous
1981	104.9	4.9%	105.3	104.0	107.7	104.0	102.8	103.4	107.5	105.0	104.5
1982	107.7	2.7	107.2	107.1	111.5	107.0	105.8	108.7	114.1	107.0	106.4
1983	109.7	1.9	109.4	110.3	111.2	109.5	107.2	107.8	119.7	109.6	110.5
1984	112.1	2.2	112.5	113.2	111.0	112.3	111.0	108.8	124.9	111.8	113.0
1985	114.4	2.1	114.4	116.2	110.6	116.1	117.5	111.1	130.5	114.1	114.5

Source: Management and Coordination Agency

Table 21: Japan's Wholesale Price Index by Industry, 1981-1985

(1980 = 100)

	Total										
	Index	Change Over Year-Earlier Period	Foods	Textiles	Lumber and Wood Products	Pulp, Paper and Paper Products	Chemicals	Petroleum and Products	Nonmetallic Mineral Products	Steel	Nonferrous Metals
1981	101.4	1.4%	104.4	100.9	90.1	97.0	97.4	109.5	103.6	101.2	86.8
1982	103.2	1.8	104.9	102.5	91.3	95.6	96.9	117.7	104.9	102.3	83.7
1983	100.9	-2.2	107.0	100.2	88.0	92.9	94.6	112.4	104.3	98.1	85.9
1984	100.6	-0.3	110.3	102.1	87.4	96.2	93.9	105.6	104.6	98.9	85.9
1985	99.5	-1.1	110.6	101.0	87.2	94.5	92.4	104.9	101.6	97.5	80.0

	Metal Products	Nonelectric Machinery and Precision Instruments	Electric Machinery	Transport Equipment	Miscellaneous Products	Agricultural, Forestry and Fishery Products	Mining Products	Utilities
1981	101.5	101.1	99.8	102.6	103.5	98.3	108.8	110.3
1982	100.0	102.0	100.3	105.5	104.0	98.7	119.7	111.9
1983	100.4	100.4	97.2	105.4	104.8	98.0	106.1	112.0
1984	103.6	100.4	96.2	106.5	105.9	98.4	101.3	112.9
1985	103.8	100.5	93.6	106.3	104.7	94.3	101.9	113.3

Source: Bank of Japan

Table 22: Japan's Wholesale Price Index by End-Use Classification, 1981-1985

(1980 = 100)

	Domestic Products										Exports			
			Intermediate Goods					Consumer Goods						
	Total	Raw Materials	Total	Semi-finished Goods	Construction Materials	Fuels and Energy	Capital Goods	Total	Durables	Nondurables	Total	Semi-finished Goods	Capital Goods	Consumer Goods
1981	101.4	103.2	100.3	98.2	96.3	111.4	102.3	102.6	99.7	103.5	101.2	97.9	102.0	100.8
1982	103.0	110.5	100.7	97.3	96.1	117.6	103.8	103.7	99.2	105.1	105.1	101.8	107.7	103.6
1983	101.2	101.7	99.4	96.3	95.4	114.0	103.8	103.8	97.8	105.6	98.8	95.9	105.5	97.8
1984	100.8	99.2	98.9	96.4	96.5	109.2	103.8	104.5	97.5	106.6	99.4	96.4	106.4	98.2
1985	99.7	97.4	97.4	94.1	95.2	109.1	104.0	104.5	97.2	106.7	98.0	94.0	106.4	96.5

Source: Bank of Japan

Table 23: Japan's Global Balance of Payments, 1981-1985

(in millions of dollars, IMF value basis, seasonally unadjusted)

		Trade Balance	Exports	Imports	Services	Transfers	Current Account Balance	Long-Term Capital	Basic Balance	Short-Term Capital	Errors and Omissions	Overall Balance	Gold and Foreign Exchange Reserves*
1981		$19,967	$149,522	$129,555	$-13,573	$-1,624	$4,770	$-9,672	$-4,902	$2,265	$493	$-2,144	$28,405
1982		18,079	137,663	119,584	-9,848	-1,381	6,850	-14,969	-8,119	-1,579	4,727	-4,971	23,262
1983		31,454	145,468	114,014	-9,106	-1,549	20,799	-17,700	3,099	23	2,055	5,177	24,496
1984		44,257	168,290	124,033	-7,747	-1,507	35,003	-49,651	-14,648	-4,295	3,745	-15,200	26,513
1985		55,986	174,015	118,029	-5,165	-1,652	49,169	-64,542	-15,373	-936	3,991	-12,318	26,510
1984	January	239	10,126	9,887	-710	-91	-562	-1,735	-2,297	-627	541	-2,383	24,669
	February	3,126	13,047	9,921	-973	-101	2,052	-2,167	-115	21	-60	-154	24,981
	March	4,228	15,423	11,195	-565	-347	3,316	-1,907	1,409	-1,467	-475	-533	25,109
	April	3,914	14,283	10,369	-288	-114	3,512	-4,392	-880	-638	-267	-1,785	25,521
	May	2,985	14,086	11,101	-893	-106	1,986	-3,703	-1,717	581	-87	-1,223	25,523
	June	4,893	14,649	9,756	-302	-107	4,484	-6,219	-1,735	37	-556	-2,254	25,208
	July	4,085	14,798	10,713	-717	-65	3,303	-7,109	-3,806	586	555	-2,665	25,123
	August	2,176	13,147	10,971	-891	-93	1,192	-3,169	-1,977	-2,041	583	-3,435	25,428
	September	5,095	14,341	9,246	-812	-99	4,184	-2,144	2,040	-512	1,249	2,777	25,444
	October	4,447	14,796	10,349	-442	-125	3,880	-3,950	-70	-696	492	-274	25,702
	November	3,783	13,838	10,055	-771	-154	2,858	-4,797	-1,939	147	-210	-2,002	26,075
	December	5,286	15,756	10,470	-383	-105	4,798	-8,359	-3,561	314	1,978	-1,269	26,313
1985	January	1,363	10,970	9,607	-479	-93	791	-3,239	-2,448	-610	690	-2,368	26,539
	February	3,275	12,779	9,504	-660	-83	2,532	-2,116	416	-605	332	143	26,244
	March	4,299	14,415	10,116	-426	-378	3,495	-5,000	-1,505	638	678	-189	26,538
	April	4,180	14,748	10,568	25	-101	4,104	-5,116	-1,012	-528	418	-1,122	26,841
	May	4,262	14,198	9,936	-594	-98	3,570	-4,255	-685	1,077	620	1,012	27,328
	June	5,751	14,293	8,542	-42	-121	5,588	-7,795	-2,207	-394	791	-1,810	27,569
	July	5,455	15,149	9,694	-454	-84	4,917	-8,770	-3,853	635	-156	-3,374	28,103
	August	4,387	13,707	9,320	-920	-68	3,399	-6,478	-3,079	219	979	-1,881	28,452
	September	5,235	14,613	9,378	-267	-189	4,779	-3,061	1,718	63	-1,277	504	27,523
	October	5,394	16,005	10,611	-508	-177	4,709	-7,082	-2,373	-1,018	785	-2,606	26,372
	November	5,357	15,340	9,983	-759	-111	4,487	-5,562	-1,075	-687	1,472	-290	26,303
	December	7,028	17,798	10,770	-81	-149	6,798	-6,068	730	274	-1,341	-337	26,510

*End of period.

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan and Ministry of Finance

Table 24: Japan's Balance of Payments with the United States, 1981-1985

(in millions of dollars, IMF value basis)

	1981	1982	1983	1984	1985
Merchandise Trade Balance	$16,297	$15,131	$21,211	$36,704	$42,988
Exports	38,717	36,477	43,057	60,479	65,617
Imports	22,420	21,346	21,846	23,775	22,629
Services Balance	-2,233	-677	-1,884	-1,495	-1,012
Transportation	-607	-733	-573	-37	110
Travel	-1,451	-1,274	-1,319	-1,369	-1,329
Investment Income	783	2,140	1,280	1,379	2,268
Other	-958	-810	-1,272	-1,468	-2,061
Official	1,060	1,148	1,314	1,397	1,495
Private	-2,018	-1,958	-2,586	-2,865	-3,556
Unilateral Transfers Balance	-193	-120	-176	-191	-249
Official	-31	-11	-18	-44	-27
Private	-162	-109	-158	-147	-222
Current Account Balance	13,871	14,334	19,151	35,018	41,727
Long-Term Capital (net)	-2,643	-1,700	-5,541	-14,814	-33,163
Direct Investments (net)	-1,871	-1,423	-1,041	-3,180	-2,043
Trade Credits (net)	-97	-788	-190	-195	-387
Loans (net)	-249	-243	-329	-477	-716
Stocks (net)	-70	813	-3,803	] -10,591	] -29,874
Bonds (net)	64	435	-140		
Other (net)	-420	-494	-38	-371	57
Basic Balance	11,228	12,634	13,610	20,204	8,564

Note: For long-term capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Bank of Japan

Table 25: Japan's Exports and Imports in Dollar Terms, 1981-1985

(in millions of dollars, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1981		$152,030	17.1%	$143,290	2.0%	$8,741
1982		138,831	-8.7	131,931	-7.9	6,900
1983		146,928	5.8	126,393	-4.2	20,534
1984		170,114	15.8	136,503	8.0	33,611
1985		175,638	3.2	129,539	-5.1	46,099
1984	January	10,198	10.6	11,037	1.0	-839
	February	13,241	20.0	11,062	14.9	2,179
	March	15,567	19.7	12,372	12.9	3,195
	April	14,446	18.3	11,337	11.4	3,108
	May	14,293	22.7	12,444	26.5	1,849
	June	14,757	20.0	10,746	3.8	4,011
	July	14,803	17.3	11,629	19.0	3,174
	August	13,312	14.4	12,204	22.6	1,108
	September	14,639	14.5	10,151	-2.4	4,488
	October	14,916	16.3	11,323	4.8	3,593
	November	13,977	12.6	10,880	-3.0	3,097
	December	15,968	4.7	11,320	-8.4	4,648
1985	January	11,057	8.4	10,596	-4.0	462
	February	12,923	-2.4	10,584	-4.3	2,340
	March	14,523	-6.7	11,333	-8.4	3,189
	April	14,871	2.9	11,613	2.4	3,259
	May	14,432	1.0	11,057	-11.1	3,375
	June	14,444	-2.1	9,424	-12.3	5,020
	July	15,291	3.3	10,693	-8.1	4,599
	August	13,860	4.1	10,370	-15.0	3,491
	September	14,758	0.8	10,177	0.3	4,581
	October	16,033	7.5	11,678	3.1	4,355
	November	15,488	10.8	10,704	-1.6	4,784
	December	17,957	12.5	11,312	-0.1	6,646

Source: Ministry of Finance

Table 26: Japan's Exports and Imports in Yen Terms, 1981-1985

(in billions of yen, customs clearance basis, seasonally unadjusted)

		Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1981		¥33,469	13.9%	¥31,464	-1.7%	¥2,005
1982		34,433	2.9	32,656	3.8	1,776
1983		34,909	1.4	30,015	-8.1	4,895
1984		40,325	15.5	32,321	7.7	8,004
1985		41,956	4.0	31,085	-3.8	10,871
1984	January	2,384	11.7	2,581	1.4	-197
	February	3,098	18.4	2,588	13.4	510
	March	3,557	15.9	2,831	9.4	727
	April	3,252	11.7	2,552	5.1	700
	May	3,256	18.9	2,831	22.2	426
	June	3,418	16.4	2,488	0.8	930
	July	3,536	16.7	2,776	18.4	760
	August	3,244	14.9	2,974	23.1	270
	September	3,560	13.7	2,467	-3.1	1,093
	October	3,680	21.4	2,793	9.4	887
	November	3,410	17.3	2,656	1.1	755
	December	3,931	9.8	2,786	-4.0	1,145
1985	January	2,795	17.2	2,671	3.5	124
	February	3,321	7.2	2,716	4.9	604
	March	3,783	6.3	2,953	4.3	830
	April	3,783	16.3	2,955	15.8	827
	May	3,629	11.4	2,779	-1.8	849
	June	3,614	5.7	2,359	-5.2	1,256
	July	3,759	6.3	2,633	-5.2	1,126
	August	3,298	1.7	2,467	-17.0	831
	September	3,534	-0.7	2,434	-1.3	1,100
	October	3,560	-3.3	2,586	-7.4	974
	November	3,242	-4.9	2,241	-15.6	1,002
	December	3,639	-7.4	2,292	-17.7	1,348

Source: Ministry of Finance

Table 27: Japan's Export and Import Volume Indexes, 1981-1985

(1980 = 100)

		Exports		Imports	
		Index	Change Over Year-Earlier Period	Index	Change Over Year-Earlier Period
1981		110.1	10.1%	97.4	-2.6%
1982		107.5	-2.4	96.8	-0.6
1983		116.8	8.7	98.1	1.3
1984		134.8	15.4	108.6	10.7
1985		141.2	4.7	108.8	0.2
1984	January	95.0	11.1	104.3	7.2
	February	123.5	17.7	104.3	21.3
	March	145.1	18.2	116.3	17.6
	April	131.9	13.5	106.4	11.8
	May	131.1	17.7	118.2	27.2
	June	139.4	16.9	100.5	2.8
	July	141.8	14.9	110.3	21.2
	August	129.3	12.8	116.1	23.0
	September	140.9	14.0	97.9	-0.6
	October	145.7	19.6	110.0	7.1
	November	136.8	17.6	107.5	1.3
	December	157.2	10.9	111.3	-4.0
1985	January	110.2	16.0	106.4	2.0
	February	129.0	4.5	106.0	1.6
	March	149.6	3.1	114.6	-1.5
	April	145.0	9.9	118.3	11.2
	May	141.5	7.9	111.4	-5.8
	June	143.1	2.7	94.4	-6.1
	July	150.6	6.2	107.5	-2.5
	August	134.1	3.7	104.2	-10.2
	September	143.6	1.9	103.6	5.8
	October	148.8	2.1	117.6	6.9
	November	139.7	2.1	108.1	0.6
	December	159.4	1.4	113.9	2.3

Source: Ministry of Finance

Table 28: Japan's Export and Import Yen-Based Price Indexes, 1981-1985

(1980 = 100)

		Exports		Imports	
		Index	Change Over Year-Earlier Period	Index	Change Over Year-Earlier Period
1981		101.2	1.2%	101.6	1.6%
1982		105.1	3.9	109.6	7.9
1983		98.8	-6.0	101.0	-7.8
1984		99.4	0.6	97.6	-3.4
1985		98.0	-1.4	95.2	-2.5
1984	January	97.9	-1.0	98.1	-6.5
	February	98.6	-0.2	98.0	-6.8
	March	97.0	-1.9	96.2	-6.4
	April	96.9	-2.0	96.0	-5.7
	May	98.3	-0.1	96.9	-2.0
	June	99.1	-0.2	96.9	-3.0
	July	101.0	1.7	98.0	-2.1
	August	100.9	1.1	98.1	-3.5
	September	101.2	1.7	98.5	-3.1
	October	101.2	3.3	98.6	0.0
	November	100.3	2.1	97.9	-0.7
	December	100.7	2.7	98.4	0.1
1985	January	101.6	3.8	99.8	1.7
	February	102.7	4.2	100.8	2.9
	March	102.4	5.6	100.3	4.3
	April	101.1	4.3	99.2	3.3
	May	100.9	2.6	98.9	2.1
	June	100.2	1.1	97.7	0.8
	July	98.9	-2.1	95.8	-2.2
	August	97.7	-3.2	94.0	-4.2
	September	97.0	-4.2	93.2	-5.4
	October	93.1	-8.0	89.5	-9.2
	November	90.6	-9.7	87.0	-11.1
	December	89.9	-10.7	86.4	-12.2

Source: Bank of Japan

Table 29: Japan's Exports by Major Market, 1981-1985

(in millions of dollars, f.o.b. value basis)

	1981	1982	1983	1984	1985
Total Exports	$152,030	$138,831	$146,928	$170,114	$175,638
Developed Countries	73,668	67,995	76,563	96,421	102,468
United States	38,609	36,330	42,829	59,937	65,278
Canada	3,399	2,861	3,625	4,297	4,520
Western Europe	23,748	21,640	23,129	23,999	25,199
United Kingdom	4,789	4,813	4,983	4,675	4,723
Netherlands	1,902	1,661	1,726	1,816	2,071
Belgium	1,436	1,155	1,325	1,339	1,477
France	2,222	2,318	2,010	1,935	2,083
West Germany	5,968	5,018	5,877	6,621	6,938
Italy	912	864	875	1,032	1,117
European Community	18,894	17,064	18,523	19,405	20,016
Sweden	802	746	798	1,009	1,094
Switzerland	1,146	1,017	1,144	1,089	1,161
Australia	4,779	4,581	4,280	5,184	5,379
New Zealand	912	929	962	1,163	1,072
South Africa	2,222	1,655	1,738	1,840	1,020
Developing Countries	68,848	62,435	61,435	63,092	56,978
Latin America	10,516	9,086	6,391	8,540	8,486
Mexico	1,705	976	579	888	994
Panama	2,210	2,925	2,169	3,444	3,326
Brazil	1,368	1,043	738	640	615
Southeast Asia	34,426	31,873	34,548	36,795	33,248
Korea	5,658	4,881	6,004	7,227	7,097
Taiwan	5,405	4,255	5,086	5,986	5,026
Hong Kong	5,311	4,718	5,289	6,559	6,509
Thailand	2,251	1,907	2,507	2,426	2,030
Singapore	4,468	4,373	4,448	4,610	3,861
Malaysia	2,424	2,502	2,771	2,875	2,168
Brunei	93	145	86	72	90
Philippines	1,928	1,803	1,744	1,080	937
Indonesia	4,123	4,261	3,552	3,073	2,175
India	1,197	1,408	1,431	1,168	1,596
Middle East and North Africa	17,732	16,946	17,160	14,206	12,171
Iran	1,486	935	2,820	1,692	1,348
Iraq	3,026	2,755	632	806	1,306
Saudi Arabia	5,876	6,621	6,687	5,654	3,890
Kuwait	1,648	1,790	1,763	1,432	1,536
Qatar	268	347	233	175	164
Oman	454	461	469	508	554
United Arab Emirates	1,494	1,493	1,357	1,126	1,164
Subsaharan Africa	5,760	4,168	2,906	2,998	2,519
Liberia	1,690	1,009	624	855	647
Nigeria	2,159	1,209	568	446	342
Communist Countries	9,514	8,401	8,830	10,602	16,190
China	5,096	3,511	4,912	7,217	12,478
U.S.S.R.	3,259	3,809	2,821	2,518	2,751

Source: Ministry of Finance

Table 30: Japan's Imports by Major Supplier, 1981-1985

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Total Imports	$143,290	$131,931	$126,393	$136,503	$129,539
Developed Countries	51,336	48,428	49,325	54,740	53,121
United States	25,297	24,179	24,648	26,862	25,793
Canada	4,464	4,441	4,430	4,945	4,773
Western Europe	11,541	10,149	11,087	13,091	12,356
United Kingdom	2,695	1,874	1,940	2,267	1,817
Netherlands	427	347	443	434	439
Belgium	337	338	376	469	482
France	1,171	1,215	1,302	1,236	1,524
West Germany	2,429	2,355	2,414	2,684	2,928
Italy	856	942	981	1,049	1,050
European Community	8,552	7,560	8,120	9,334	8,893
Sweden	333	352	452	473	441
Switzerland	1,542	1,233	1,412	1,965	1,758
Australia	7,419	6,961	6,642	7,296	7,452
New Zealand	887	858	932	935	903
South Africa	1,728	1,840	1,587	1,611	1,811
Developing Countries	84,223	76,069	70,060	73,778	67,936
Latin America	6,669	6,268	6,462	7,230	6,242
Mexico	1,437	1,522	1,889	2,260	1,870
Panama	131	107	68	168	81
Brazil	1,579	1,603	1,669	1,991	1,840
Southeast Asia	31,950	29,985	27,988	31,883	30,264
Korea	3,389	3,254	3,365	4,213	4,092
Taiwan	2,523	2,443	2,622	3,204	3,386
Hong Kong	669	622	670	842	767
Thailand	1,061	1,041	1,019	1,040	1,027
Singapore	1,944	1,826	1,468	1,775	1,591
Malaysia	2,927	3,010	3,131	4,412	4,330
Brunei	2,908	2,636	2,367	2,203	1,892
Philippines	1,731	1,576	1,307	1,419	1,243
Indonesia	13,505	12,005	10,452	11,176	10,119
India	1,057	1,122	1,131	1,132	1,189
Middle East and North Africa	42,670	37,764	33,796	33,066	29,927
Iran	1,920	2,567	4,231	2,869	2,506
Iraq	934	780	141	172	622
Saudi Arabia	21,483	20,528	15,530	14,734	10,215
Kuwait	3,609	1,627	1,387	1,589	1,162
Qatar	2,235	1,784	1,701	2,594	2,185
Oman	2,327	1,702	2,012	2,420	3,066
United Arab Emirates	8,836	7,983	7,794	7,720	8,916
Subsaharan Africa	2,405	1,610	1,345	1,166	1,052
Liberia	312	166	38	99	58
Nigeria	340	8	7	7	6
Communist Countries	7,724	7,431	7,004	7,982	8,180
China	5,292	5,352	5,087	5,958	6,483
U.S.S.R.	2,021	1,682	1,456	1,591	1,429

Source: Ministry of Finance

Table 31: Japan's Trade Balance with Major Trading Partners, 1981-1985

(in millions of dollars)

	1981	1982	1983	1984	1985
Overall Balance	$8,741	$6,900	$20,534	$33,611	$46,099
Developed Countries	22,332	19,567	27,259	41,680	49,347
United States	13,312	12,131	18,181	33,075	39,485
Canada	-1,065	-1,580	-805	-648	-253
Western Europe	12,207	11,491	12,042	10,908	12,843
United Kingdom	2,095	2,939	3,043	2,408	2,906
Netherlands	1,476	1,314	1,283	1,381	1,632
Belgium	1,100	817	948	870	995
France	1,050	1,103	708	700	759
West Germany	3,538	2,663	3,464	3,937	4,010
Italy	57	-78	-106	-17	67
European Community	10,341	9,504	10,402	10,071	11,124
Sweden	469	394	546	537	653
Switzerland	-397	-216	-269	-876	-597
Australia	-2,640	-2,581	-2,362	-2,112	-2,073
New Zealand	25	71	31	228	169
South Africa	494	-185	151	229	-824
Developing Countries	-15,575	-13,634	-8,625	-10,686	-10,958
Latin America	3,847	2,818	-71	1,318	2,244
Mexico	268	-546	-1,310	-1,372	-876
Panama	2,079	2,818	2,101	3,276	3,245
Brazil	-211	-560	-931	-1,351	-1,225
Southeast Asia	2,496	1,888	6,560	4,912	2,984
Korea	2,269	1,627	2,639	3,014	3,005
Taiwan	2,882	1,812	2,463	2,782	1,640
Hong Kong	4,641	4,096	4,619	5,717	5,742
Thailand	1,190	866	1,488	1,585	1,004
Singapore	2,524	2,547	2,981	2,835	2,267
Malaysia	-503	-508	-360	-1,537	-2,162
Brunei	-2,814	-2,491	-2,281	-2,131	-1,802
Philippines	197	227	457	-339	-507
Indonesia	-9,185	-7,744	-6,880	-8,102	-7,947
India	141	286	500	35	408
Middle East and North Africa	-24,938	-20,818	-16,636	-18,861	-17,766
Iran	-455	-1,632	-1,412	-1,177	-1,158
Iraq	2,092	1,976	491	634	684
Saudi Arabia	-15,606	-13,906	-8,843	-9,100	-6,355
Kuwait	-1,961	163	575	-157	374
Qatar	-1,967	-1,436	-1,468	-2,419	-2,021
Oman	-1,874	-1,242	-1,544	-1,912	-2,512
United Arab Emirates	-7,342	-6,490	-6,436	-6,594	-7,752
Subsaharan Africa	3,356	2,558	1,561	1,833	1,466
Liberia	1,378	843	587	756	589
Nigeria	1,819	1,201	561	439	336
Communist Countries	1,790	970	1,926	2,620	7,710
China	-196	-1,842	-175	1,259	5,995
U.S.S.R.	1,239	2,217	1,565	1,124	1,521

Source: Ministry of Finance

Table 32: Japan's Exports by Commodity, 1981-1985

(in millions of dollars, f.o.b. value basis)

	1981	1982	1983	1984	1985
Total Exports	$152,030	$138,831	$146,928	$170,114	$175,658
Food and Live Animals	1,583	1,270	1,246	1,290	1,202
Fish and Fish Products	757	681	663	717	685
Beverages and Tobacco	156	131	144	150	114
Crude Materials (excl. fuels)	1,381	1,159	1,194	1,250	1,240
Textile Fibers and Waste	762	619	644	659	655
Mineral Fuels	554	411	432	505	539
Animal and Vegetable Oils and Fats	96	88	118	148	111
Chemicals	6,841	6,365	6,983	7,626	7,698
Chemical Elements and Compounds	2,961	2,751	2,945	3,121	3,243
Organic Chemicals	2,184	2,040	2,177	2,371	2,512
Inorganic Chemicals	767	702	755	738	720
Plastic Materials	1,915	1,798	2,039	2,351	2,261
Manufactured Goods Classified Mainly by Material	33,687	31,100	28,935	30,137	28,836
Tires and Other Rubber Manufactures	2,002	1,665	1,823	1,973	1,895
Tires for Motor Vehicles	1,359	1,111	1,267	1,382	1,302
Paper and Paper Products	878	846	872	994	1,029
Textiles (excl. fibers and apparel)	5,833	5,075	5,311	5,318	4,900
Yarn and Thread	1,253	1,022	1,122	1,168	1,000
Woven Fabrics	3,937	3,438	3,626	3,546	3,361
Made-up Articles (excl. clothing)	643	615	563	604	540
Nonmetallic Mineral Manufactures	2,122	1,945	2,150	2,272	2,148
Glass and Glassware	374	351	422	518	594
Tableware	560	458	518	569	528
Iron and Steel	16,669	15,645	12,843	13,852	13,566
Bars, Rods, Shapes and Sections	2,015	2,116	1,816	1,715	1,777
Wire Rods	539	339	529	626	568
Universals, Plates and Sheets	4,989	4,753	5,339	5,706	5,209
Hoops and Strip	1,402	1,191	1,509	1 468	1,285
Tubes, Pipes and Fittings	7,218	6,295	3,370	3,742	4,023
Nonferrous Metals	1,467	1,282	1,588	1,501	1,467
Copper and Alloys	637	590	839	614	585
Aluminum and Alloys	352	396	473	619	615
Metal Manufactures	4,320	4,288	3,941	3,812	3,158
Finished Structural Parts and Structures	1,045	1,103	1,047	751	528
Nails and Industrial Fasteners	513	431	473	603	516
Tools	643	551	594	666	701
Machinery and Transport Equipment	86,362	78,069	85,133	102,680	108,587
Nonelectric Machinery	22,628	20,317	23,103	27,870	29,537
Power Generating Machinery	3,174	2,792	2,992	5,835	3,789
Internal Combustion Engines	2,294	1,955	2,240	2,800	2,885
Agricultural Machinery	1,082	950	1,160	1,119	1,028
Tractors	911	794	943	841	746

(continued)

Table 32: Japan's Exports by Commodity, 1981-1985 (continued)

(in millions of dollars, f.o.b. value basis)

	1981	1982	1983	1984	1985
Office Machinery	$2,637	$3,139	$5,139	$7,554	$7,785
Calculators	629	542	554	698	660
Data Processing Equipment	873	1,361	2,849	4,566	4,625
Metalworking Machinery	2,071	1,441	1,489	2,021	2,599
Lathes	577	372	302	423	524
Textile Machinery	882	668	759	869	1,007
Sewing Machines	502	424	457	526	524
Construction and Mining Machinery	1,722	1,885	1,725	1,709	1,995
Excavators	673	687	619	813	965
Heating and Cooling Machinery	2,554	2,060	2,142	1,887	1,588
Pumps and Centrifuges	1,791	1,495	1,535	1,671	1,678
Mechanical Handling Equipment	1,614	1,440	1,404	1,559	1,609
Bearings	590	497	512	558	651
Electric Machinery	22,466	19,718	22,886	29,245	29,701
Electric Power Machinery	2,039	1,787	1,873	2,137	2,058
Generators	645	666	628	630	532
Switchboards and Control Panels	647	485	533	691	594
Insulated Wire and Cable	947	826	781	684	701
Telecommunications Equipment	9,801	8,025	8,867	11,077	12,242
Televisions	1,929	1,489	1,472	1,905	2,625
Radios	3,223	2,401	2,440	2,820	2,658
Microphones, Loudspeakers and Amplifiers	1,112	739	848	963	981
Household Electric Appliances	1,310	1,106	1,412	1,817	1,968
Electronic Tubes and Semiconductors	2,662	2,686	3,731	5,816	4,753
Automotive Electrical Equipment	588	540	602	681	724
Electronic Measuring and Controlling Instruments	604	648	784	964	1,127
Transport Equipment	41,267	38,033	39,143	45,556	49,149
Railway Equipment	495	519	411	764	525
Road Motor Vehicles	26,521	24,559	26,123	29,821	34,377
Cars	18,445	18,015	19,535	21,899	25,402
Assembled Trucks and Buses	6,069	4,940	5,175	6,372	7,396
Truck and Bus Chassis with Engines	1,896	1,457	1,371	1,475	1,517
Road Motor Vehicle Parts	2,565	2,564	3,423	4,513	5,228
Motorcycles and Parts	3,813	3,062	2,667	2,598	2,626
Ships and Boats	7,274	6,870	5,996	7,353	5,929
Tankers	1,753	1,468	719	693	634
Cargo Ships	2,657	2,924	3,086	4,181	3,490
Miscellaneous Manufactured Goods	19,985	18,723	21,198	24,655	25,752
Clothing	578	547	659	776	728
Scientific, Medical and Optical Instruments	5,512	4,842	8,213	9,268	10,046
Still Cameras	1,091	896	1,127	1,217	1,232
Measuring Instruments	521	454	497	607	676
Watches and Clocks	2,014	1,441	1,550	1,747	1,730
Stereo Equipment and Audio and Video Cassette Recorders and Players	6,274	6,163	7,439	9,222	9,230
Video Cassette Recorders	n.a.	4,337	5,304	6,819	6,622
Phonograph Records and Tapes	1,034	1,358	1,383	1,503	1,665
Musical Instruments	542	505	555	640	688
Unclassified Commodities	1,386	1,516	1,546	1,674	1,759

Source: Ministry of Finance

Table 33: Japan's Imports by Commodity, 1981-1985

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Total Imports	$143,290	$131,931	$126,393	$136,503	$129,539
Food and Live Animals	15,122	13,745	14,051	15,191	14,787
Meat and Meat Products	1,927	1,711	1,772	1,897	1,927
Pork	717	542	645	714	703
Fish and Fish Products	3,653	3,918	3,884	4,096	4,610
Fresh or Frozen Shrimp and Lobster	1,277	1,372	1,349	1,354	1,451
Grains and Cereal Products	4,990	3,960	4,191	4,743	3,951
Wheat	1,273	1,120	1,126	1,114	974
Corn for Mixed Feed	1,867	1,381	1,572	1,669	1,363
Sorghum for Mixed Feed	546	419	386	608	536
Fruits and Vegetables	1,678	1,609	1,613	1,828	1,828
Fruits	954	958	973	1,055	1,135
Vegetables	725	651	639	733	693
Sugar	732	474	393	295	210
Coffee	543	615	649	770	747
Animal Feeds	509	404	548	539	474
Beverages and Tobacco	792	830	845	836	760
Unmanufactured Tobacco	422	446	441	429	355
Crude Materials (excl. fuels)	19,720	18,636	17,943	19,153	17,715
Hides and Skins	517	441	412	568	504
Oilseeds and Oil Nuts	2,018	1,727	1,952	2,210	1,875
Soybeans	1,396	1,156	1,375	1,447	1,206
Rubber	625	451	597	638	544
Logs and Lumber	4,459	4,546	3,887	3,909	3,700
Logs	3,674	3,626	3,045	3,107	2,781
Wood Pulp	863	845	888	1,001	910
Textile Fibers and Waste	2,404	2,327	2,077	2,484	2,155
Wool	688	712	560	675	670
Cotton	1,416	1,271	1,145	1,342	1,049
Crude Minerals	801	816	838	1,050	1,088
Metal Ores, Concentrates and Scrap	7,284	6,757	6,513	6,572	6,232
Iron Ore and Concentrates	3,504	3,630	3,147	3,199	3,045
Steel Scrap	266	263	451	529	407
Nonferrous Ores	3,011	2,530	2,403	2,334	2,229
Copper	1,676	1,419	1,475	1,255	1,209
Nonferrous Scrap	502	333	507	502	546
Mineral Fuels	72,563	65,618	58,925	60,357	55,790
Coal	5,521	5,782	4,877	5,311	5,197
Coking Coal	4,685	4,849	4,053	4,386	4,154
Petroleum and Products	58,674	51,409	45,705	45,486	40,575
Crude Petroleum	53,343	46,274	40,063	39,379	34,599
Petroleum Products	5,331	5,135	5,642	6,107	5,976
Residual Fuel Oil	1,848	1,691	1,807	2,130	2,020
Natural and Manufactured Gas	8,357	8,416	8,332	9,529	10,006
Liquefied Petroleum Gas	3,234	3,219	3,285	2,935	2,805
Liquefied Methane Gas	n.a.	5,197	5,046	6,594	7,200

(continued)

Table 33: Japan's Imports by Commodity, 1981-1985 (continued)

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Animal and Vegetable Oils and Fats	$315	$275	$268	$372	$329
Chemicals	6,487	6,824	7,207	8,346	8,073
Chemical Elements and Compounds	3,028	3,193	3,551	4,370	4,142
Organic Chemicals	1,847	1,830	2,112	2,423	2,411
Inorganic Chemicals	669	556	526	677	742
Pharmaceuticals	1,150	1,249	1,215	1,259	1,292
Plastic Materials	644	672	672	763	745
Manufactured Goods Classified Mainly by Material	10,158	9,848	10,147	11,932	10,886
Wood Manufactures	912	813	771	842	858
Wood Chips	745	643	603	645	604
Paper and Paper Products	479	513	522	545	545
Textiles (excl. fibers and apparel)	1,628	1,602	1,487	1,926	1,891
Nonmetallic Mineral Manufactures	1,118	1,032	1,101	1,201	1,264
Diamonds	543	477	526	558	567
Iron and Steel	1,067	1,216	1,349	1,912	1,480
Ferroalloys	357	390	411	588	524
Nonferrous Metals	4,189	3,885	4,127	4,700	4,042
Precious Metals	857	599	740	818	713
Copper and Alloys	639	611	420	816	592
Aluminum and Alloys	1,849	1,938	2,165	2,076	1,861
Metal Manufactures	428	471	500	507	512
Machinery and Transport Equipment	9,240	8,181	9,385	10,809	11,106
Nonelectric Machinery	3,597	3,777	3,665	4,495	4,728
Power Generating Machinery	488	595	670	939	896
Aircraft Engines	283	363	389	458	650
Office Machinery	1,027	1,003	1,026	1,362	1,545
Computers, Peripheral Equipment and Parts	967	951	979	1,318	1,509
Electric Machinery	2,939	2,994	3,221	3,989	3,795
Electronic Tubes and Semiconductors	789	747	909	1,291	1,016
Telecommunications Equipment	411	416	427	465	458
Electronic Measuring and Controlling Instruments	499	542	566	598	643
Transport Equipment	2,703	1,410	2,499	2,325	2,583
Cars	326	348	398	457	539
Aircraft	1,340	800	1,472	928	1,484
Ships and Boats	844	78	390	645	286
Miscellaneous Manufactured Goods	5,386	5,398	5,204	6,088	6,349
Clothing	1,802	1,832	1,501	1,949	1,995
Scientific, Medical and Optical Instruments	765	737	790	947	929
Unclassified Commodities	3,509	2,576	2,418	3,439	3,711

Source: Ministry of Finance

Table 34: Japan's Dollar-Based Trade with the United States, 1981-1985

(in millions of dollars, customs clearance basis, seasonally unadjusted)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1981	$38,609	23.1%	$25,297	3.6%	$13,312
1982	36,330	-5.9	24,179	-4.4	12,151
1983	42,829	17.9	24,648	1.9	18,181
1984	59,937	39.9	26,862	9.0	33,075
1985	65,278	8.9	25,793	-4.0	39,485
1984 January	3,406	34.9	2,143	11.6	1,263
February	4,405	55.9	2,266	31.3	2,139
March	4,691	44.2	2,274	14.6	2,417
April	5,141	50.4	2,128	14.1	3,013
May	5,080	57.0	2,426	15.7	2,654
June	5,227	41.9	2,197	-1.3	3,030
July	5,565	51.0	2,330	7.7	3,235
August	4,848	42.9	2,413	17.4	2,435
September	5,345	30.9	2,035	1.7	3,309
October	5,519	36.6	2,283	10.4	3,236
November	5,241	30.4	2,028	-2.8	3,213
December	5,471	17.3	2,339	-4.7	3,132
1985 January	4,102	20.4	2,206	2.9	1,896
February	4,558	3.5	2,229	-1.7	2,329
March	4,686	-0.1	2,337	2.8	2,349
April	5,784	12.5	2,325	9.3	3,459
May	5,699	12.2	2,289	-5.7	3,411
June	5,354	2.4	2,027	-7.7	3,327
July	5,825	4.6	2,129	-8.6	3,695
August	5,130	5.8	2,101	-12.9	3,030
September	5,661	5.9	1,881	-7.6	3,780
October	6,038	9.4	2,357	3.2	3,681
November	6,058	15.6	2,029	0.1	4,029
December	6,384	16.7	1,883	-19.5	4,501

Source: Ministry of Finance

Table 35: Japan's Yen-Based Trade with the United States, 1981-1985

(in billions of yen, customs clearance basis, seasonally unadjusted)

	Exports (f.o.b.)	Change Over Year-Earlier Period	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1981	¥8,519	19.7%	¥5,552	-0.1%	¥2,966
1982	9,015	5.8	5,991	7.9	3,025
1983	10,179	12.9	5,855	-2.3	4,323
1984	14,221	39.7	6,364	8.7	7,858
1985	15,583	9.6	6,213	-2.4	9,369
1984 January	796	36.3	501	12.0	295
February	1,031	53.8	530	29.6	500
March	1,072	39.6	520	11.1	551
April	1,157	41.9	479	7.6	678
May	1,157	52.2	552	11.8	606
June	1,211	37.6	509	-4.2	702
July	1,329	50.3	556	7.1	773
August	1,182	43.4	588	17.9	594
September	1,300	30.0	495	0.9	805
October	1,362	42.5	563	15.3	798
November	1,279	35.7	495	1.3	784
December	1,347	23.6	576	-0.1	771
1985 January	1,037	30.2	556	10.9	481
February	1,171	13.6	572	7.9	599
March	1,221	13.9	609	17.0	612
April	1,471	27.1	592	23.5	879
May	1,433	23.8	575	4.2	858
June	1,340	10.7	507	-0.3	832
July	1,432	7.7	524	-5.8	907
August	1,221	3.3	500	-15.0	721
September	1,356	4.3	450	-9.0	906
October	1,341	-1.5	522	-7.3	819
November	1,268	-6.9	425	-14.2	843
December	1,294	-3.9	382	-33.7	912

Source: Ministry of Finance

Table 36: Yen-Dollar Exchange Rate Used to Convert Customs Clearance Trade Data, 1981-1985*

	Exports	Imports
1981 Average	Y219.90	Y219.94
1982 Average	248.33	248.30
1983 Average	237.52	237.59
1984 Average	236.95	236.91
1985 Average	240.29	240.17
1984 January	233.79	233.83
February	233.97	233.98
March	228.50	225.79
April	225.09	225.10
May	227.82	227.48
June	231.61	231.56
July	238.87	238.69
August	243.72	243.69
September	243.17	243.02
October	246.71	246.68
November	243.98	244.08
December	246.17	246.07
1985 January	252.76	252.04
February	256.95	256.66
March	260.47	260.53
April	254.35	254.49
May	251.43	251.36
June	250.20	250.26
July	245.82	246.22
August	237.94	237.92
September	239.47	239.20
October	222.05	221.43
November	209.33	209.32
December	202.67	202.60

*Reflects the exchange rate that prevailed at the time export or import contracts were signed.

Source: Ministry of Finance

Table 37: Yen-Dollar Exchange Rate on Tokyo Foreign Exchange Market, 1981-1985

(average for period)

	1981	1982	1983	1984	1985
Average	Y220.54	Y249.08	Y237.51	Y237.52	Y238.54
January	202.00	224.59	232.94	233.94	254.18
February	205.89	235.17	236.24	233.68	260.24
March	208.82	240.72	238.03	225.40	258.63
April	215.14	244.86	237.71	224.95	251.67
May	220.66	236.90	234.74	230.66	251.54
June	224.20	251.04	240.15	233.21	248.99
July	231.96	255.12	240.50	242.84	241.75
August	233.69	258.82	244.33	242.30	237.21
September	230.02	262.65	242.77	245.23	236.95
October	231.37	271.40	233.01	246.79	214.73
November	223.74	265.13	235.31	243.32	203.72
December	218.94	242.52	234.41	247.95	202.82

Source: International Monetary Fund

Table 38: Japan's Foreign Direct Investment by Country, FY 1981-FY 1985

(in millions of dollars)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	Total March 31, 1986
United States	$2,354	$2,738	$2,565	$3,360	$5,395	$25,290
Canada	167	167	136	184	100	1,675
North America	2,522	2,905	2,701	3,544	5,495	26,965
Panama	614	722	1,223	1,671	1,533	6,400
Brazil	316	322	410	318	314	4,587
Mexico	82	143	121	56	101	1,330
Peru	4	185	0	6	10	696
Bermuda	32	5	14	29	148	601
Latin America	1,181	1,503	1,878	2,290	2,616	15,636
Indonesia	2,434	410	374	374	408	8,423
Hong Kong	329	400	563	412	131	2,931
Singapore	266	180	322	225	339	2,269
Korea	73	103	129	107	134	1,683
Malaysia	31	83	140	142	79	1,125
Philippines	72	34	65	46	61	892
Taiwan	54	55	103	65	114	761
Thailand	31	94	72	119	48	760
Asia	3,338	1,384	1,847	1,628	1,435	19,463
Kuwait	50	41	66	55	34	1,268
Iran	0	0	1	0	0	1,003
Middle East	96	124	175	273	45	2,972
United Kingdom	110	176	153	318	375	3,141
Netherlands	138	73	113	452	613	1,687
West Germany	116	194	117	245	172	1,343
Luxembourg	104	127	265	315	300	1,216
France	54	102	93	117	67	819
Belgium	107	64	126	71	84	743
Switzerland	67	79	37	229	60	663
Spain	39	19	52	140	91	514
Europe	798	876	990	1,937	1,930	11,002
Liberia	466	434	323	281	159	2,455
Africa	573	489	364	326	172	3,369
Australia	348	370	166	105	468	3,621
Oceania	424	421	191	157	525	4,242
Total	8,931	7,703	8,145	10,155	12,217	83,649

Source: Ministry of Finance

Table 39: Japan's Foreign Direct Investment by Industry, FY 1981-FY 1985

(in millions of dollars)

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	Total March 31, 1986
Manufacturing Sector	$2,305	$2,076	$2,588	$2,505	$2,352	$24,400
Food Products	142	78	77	118	90	1,091
Textiles	91	67	174	85	28	2,083
Wood Products	65	76	91	115	15	1,120
Chemicals	228	322	450	223	133	3,982
Metals	521	468	479	718	385	5,190
Nonelectric Machinery	207	164	169	185	352	1,971
Electric Machinery	475	267	502	409	513	3,747
Transport Equipment	406	439	486	437	627	3,373
Other	169	195	160	215	208	1,841
Nonmanufacturing Sector	6,516	5,478	5,357	7,429	9,536	56,337
Agriculture/ Forestry	75	40	18	26	12	780
Fisheries	36	22	17	24	42	442
Mining	2,534	685	382	484	598	11,756
Construction	96	44	55	112	94	798
Trade/Sales	1,174	1,899	1,164	1,482	1,550	12,677
Banking/Finance/ Insurance	843	533	1,167	2,085	3,805	10,859
Services	623	702	622	681	665	4,686
Transportation	722	924	1,363	1,651	1,240	5,900
Real Estate	167	354	375	430	1,207	2,533
Other	246	276	193	454	322	5,906
Branch Offices	110	149	200	221	329	2,318
Real Estate Transactions*	---	---	---	---	---	595
Total	8,931	7,703	8,145	10,155	12,217	83,649

*Overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980 because of changes in the Foreign Exchange and Foreign Trade Control Law.

Source: Ministry of Finance

Table 40: U.S. International Transactions, 1981-1985

(in millions of dollars, IMF value basis)

	1981	1982	1983	1984	1985
Merchandise Trade Balance	$-27,978	$-36,444	$-67,080	$-112,522	$-124,439
Exports	237,085	211,198	201,820	219,900	214,424
Imports	265,063	247,642	268,900	332,422	338,863
Services Balance	41,742	36,229	29,956	18,213	21,746
Military	-1,183	-274	-369	-1,827	-2,917
Travel	58	-1,599	-4,595	-7,570	-9,172
Other Transportation	86	607	368	-1,023	-1,956
Investment Income	34,082	28,666	24,841	18,752	25,188
Direct	25,651	18,226	14,901	12,280	26,252
Other	8,431	10,440	9,940	6,472	-1,064
Fees and Royalties	6,633	4,558	4,502	4,583	4,976
Other Services	2,066	4,271	5,209	5,298	5,627
Unilateral Transfers Balance	-7,425	-8,917	-9,481	-12,157	-14,983
Current Account Balance	6,339	-9,132	-46,605	-106,466	-117,676
Private Capital Flows (net)	-22,396	-19,691	35,706	84,744	102,675
Direct Investments (net)	15,571	16,161	11,573	21,501	-896
Securities (net)	4,344	5,342	10,350	30,736	63,382
Banking Flows (net)	-42,047	-45,437	20,414	22,722	39,696
Other Flows (net)	-264	4,243	-6,631	9,785	493
U.S. Government Assets (other than official reserves) (net)	-5,097	-6,131	-5,005	-5,523	-2,824
U.S. Official Reserve Assets	-5,175	-4,965	-1,196	-3,131	-3,858
Foreign Official Reserve Assets	4,960	3,593	5,968	3,037	-1,324
Allocations of Special Drawing Rights	1,093	0	0	0	0
Statistical Discrepancy	20,276	36,325	11,130	27,338	23,006

Note: For capital transactions, credits (+) indicate net inflows and debits (-) indicate net outflows.

Source: Department of Commerce

Table 41: U.S. Current Account Balance with Japan, 1981-1985

(in millions of dollars, IMF value basis)

	1981	1982	1983	1984	1985
Merchandise Trade Balance	$-15,802	$-16,989	$-21,055	$-36,969	$-43,508
Exports	21,796	20,694	21,789	23,241	22,145
Imports	37,598	37,683	42,844	60,210	65,653
Services Balance	1,948	1,655	1,339	-644	-1,760
Military	-722	-870	-917	-1,035	-1,203
Travel	1,059	1,211	1,307	1,396	1,451
Other Transportation	-278	-134	-177	-471	-732
Investment Income	1,014	498	39	-1,589	-2,527
Direct	214	250	92	-1,130	-115
Other	800	248	-53	-459	-2,412
Fees and Royalties	838	919	809	827	915
Other Services	37	31	278	208	336
Unilateral Transfers Balance	-70	-90	-49	-64	-54
Current Account Balance	-13,924	-15,424	-19,765	-37,697	-45,322

Source: Department of Commerce

Table 42: U.S. Exports and Imports, 1981-1985

(in millions of dollars, seasonally unadjusted)

		Exports* (f.a.s.)	Change Over Year-Earlier Period	Imports (Customs)	Change Over Year-Earlier Period	Trade Balance	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1981		$233,739	5.9%	$260,982	6.4%	$-27,243	$273,352	6.4%	$-39,613
1982		212,275	-9.2	243,952	-6.5	-31,677	254,885	-6.8	-42,610
1983		200,538	-5.5	258,048	5.8	-57,510	269,878	5.9	-69,341
1984		217,888	8.7	325,726	26.2	-107,838	341,177	26.4	-123,289
1985		213,146	-2.2	345,276	6.0	-132,129	361,626	6.0	-148,480
1984	January	17,166	5.9	26,497	31.5	-9,331	27,697	31.3	-10,532
	February	17,015	9.5	25,118	42.8	-8,103	25,233	42.4	-9,218
	March	19,608	7.0	27,731	36.5	-8,123	28,988	36.7	-9,380
	April	17,783	6.4	28,160	42.2	-10,377	29,483	42.4	-11,700
	May	18,738	15.4	26,607	21.3	-7,870	27,875	21.7	-9,137
	June	18,381	4.7	25,964	19.3	-7,583	27,178	19.6	-8,797
	July	18,363	15.5	31,565	46.2	-13,202	33,175	46.8	-14,812
	August	17,312	10.7	27,043	17.3	-9,731	28,411	17.8	-11,099
	September	17,601	4.5	27,853	28.1	-10,252	29,185	28.4	-11,584
	October	18,612	7.9	27,530	9.5	-8,919	28,847	9.7	-10,235
	November	18,175	8.1	27,296	17.1	-9,121	28,579	17.2	-10,404
	December	19,136	9.3	24,363	12.4	-5,227	25,528	12.6	-6,392
1985	January	18,673	8.8	28,836	8.8	-10,163	30,245	9.2	-11,572
	February	17,143	0.8	25,941	3.3	-8,798	27,169	3.6	-10,026
	March	20,330	3.7	28,725	3.6	-8,395	30,107	3.9	-9,777
	April	17,973	1.1	28,572	1.5	-10,599	29,907	1.4	-11,935
	May	18,337	-2.1	29,302	10.1	-10,965	30,712	10.2	-12,375
	June	18,012	-2.0	30,136	16.1	-12,124	31,596	16.3	-13,584
	July	16,727	-8.9	27,000	-14.5	-10,274	28,312	-14.7	-11,585
	August	16,584	-4.2	26,247	-2.9	-9,663	27,512	-3.2	-10,927
	September	17,034	-3.2	31,349	12.6	-14,315	32,860	12.6	-15,826
	October	17,618	-5.3	28,429	3.3	-10,811	29,695	2.9	-12,077
	November	17,721	-2.5	30,010	9.9	-12,290	31,371	9.8	-13,651
	December	16,994	-11.2	30,728	26.1	-13,734	32,141	25.9	-15,146

*Domestic and foreign merchandise, including Department of Defense shipments.

Source: Department of Commerce

Table 43: U.S. Exports by Major Market, 1981-1985

(in millions of dollars, f.a.s. value basis)

	1981	1982	1983	1984	1985
Total	$233,739	$212,275	$200,538	$217,888	$213,146
Japan	21,823	20,966	21,894	23,575	22,631
Canada	39,564	33,720	38,244	46,524	47,251
Western Europe	65,377	60,054	55,980	58,019	56,763
United Kingdom	12,439	10,645	10,621	12,210	11,273
West Germany	10,277	9,291	8,737	9,084	9,050
Netherlands	8,595	8,604	7,767	7,554	7,269
France	7,341	7,110	5,961	6,037	6,096
Belgium-Luxembourg	5,765	5,229	5,049	5,301	4,918
Italy	5,360	4,616	3,908	4,375	4,625
European Community	52,363	47,932	44,311	46,976	45,776
Spain	3,397	3,456	2,763	2,561	2,524
Switzerland	3,022	2,707	2,960	2,563	2,288
Sweden	1,842	1,689	1,581	1,542	1,925
Asia (excl. Japan) and Middle East	38,413	40,912	39,725	37,931	34,239
Korea	5,116	5,529	5,925	5,983	5,956
Taiwan	4,305	4,367	4,667	5,003	4,700
Saudi Arabia	7,327	9,026	7,903	5,564	4,474
Singapore	3,003	3,214	3,759	3,675	3,476
Hong Kong	2,635	2,453	2,564	3,062	2,786
Israel	2,521	2,271	2,017	2,194	2,580
India	1,748	1,599	1,828	1,570	1,642
Malaysia	1,537	1,736	1,684	1,856	1,539
Philippines	1,787	1,854	1,807	1,766	1,379
Pakistan	492	700	812	1,093	1,042
Thailand	1,170	915	1,063	1,113	849
Indonesia	1,302	2,025	1,466	1,216	795
Western Hemisphere (excl. Canada)	42,102	33,592	25,726	29,684	31,020
Mexico	17,789	11,817	9,082	11,992	13,635
Venezuela	5,445	5,206	2,811	3,377	3,399
Brazil	3,798	3,423	2,557	2,640	3,140
Colombia	1,771	1,903	1,514	1,450	1,468
Africa	11,097	10,271	8,768	8,827	7,388
Egypt	2,159	2,875	2,813	2,704	2,323
South Africa	2,912	2,368	2,129	2,265	1,205
Nigeria	1,523	1,295	864	577	676
Australia and Oceania	6,436	5,700	4,827	5,745	6,399
Australia	5,242	4,535	3,954	4,793	5,441
Communist Countries in Asia	3,613	2,945	2,194	3,027	3,876
China	3,603	2,912	2,173	3,004	3,856
Eastern Europe	4,338	3,610	2,891	4,188	3,215
Soviet Union	2,431	2,587	2,003	3,284	2,423

Source: Department of Commerce

Table 44: U.S. Imports by Major Supplier, 1981-1985

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Total	$273,352	$254,885	$269,878	$341,177	$361,626
Japan	39,904	39,932	43,559	60,371	72,380
Canada	46,827	46,792	52,546	66,911	69,427
Western Europe	54,376	54,802	56,437	74,921	84,209
United Kingdom	13,315	13,541	12,900	15,044	15,573
West Germany	11,918	12,503	13,229	17,810	21,232
Netherlands	2,520	2,652	3,149	4,330	4,368
France	6,139	5,815	6,308	8,516	9,960
Belgium-Luxembourg	2,409	2,502	2,510	3,287	3,567
Italy	5,549	5,656	5,819	8,504	10,381
European Community	43,653	44,466	45,879	60,267	68,246
Spain	1,661	1,636	1,685	2,627	2,774
Switzerland	2,504	2,394	2,552	3,199	3,579
Sweden	1,799	2,092	2,549	3,427	4,339
Asia (excl. Japan) and Middle East	55,828	48,046	51,243	64,293	63,460
Korea	5,474	6,011	7,657	10,027	10,713
Taiwan	8,631	9,587	12,110	16,088	17,761
Saudi Arabia	15,237	7,860	3,840	4,009	2,027
Singapore	2,195	2,274	2,969	4,121	4,412
Hong Kong	5,757	5,895	6,825	8,899	8,994
Israel	1,280	1,209	1,300	1,809	2,201
India	1,325	1,522	2,334	2,737	2,478
Malaysia	2,272	1,959	2,205	2,825	2,599
Philippines	2,161	1,956	2,159	2,622	2,334
Pakistan	189	181	183	268	299
Thailand	1,007	956	1,035	1,426	1,543
Indonesia	6,413	4,509	5,657	5,868	4,933
Western Hemisphere (excl. Canada)	40,805	39,604	43,581	50,063	49,096
Mexico	14,013	15,770	17,019	18,267	19,392
Venezuela	5,800	4,957	5,173	6,820	6,830
Brazil	4,852	4,643	5,382	8,273	8,147
Colombia	900	883	1,058	1,253	1,456
Africa	28,127	18,537	15,206	14,996	12,543
Egypt	412	569	325	182	84
South Africa	2,553	2,048	2,099	2,577	2,180
Nigeria	9,554	7,274	3,883	2,606	3,108
Australia and Oceania	3,717	3,501	3,354	3,885	4,170
Australia	2,707	2,552	2,422	2,899	3,069
Communist Countries in Asia	2,067	2,505	2,478	3,384	4,228
China	2,062	2,502	2,477	3,381	4,224
Eastern Europe	1,698	1,162	1,474	2,352	2,114
Soviet Union	401	247	374	600	443

Source: Department of Commerce

Table 45: U.S. Trade Balance with Major Trading Partners, 1981-1985

(in millions of dollars)

	1981	1982	1983	1984	1985
Total	$-39,613	$-42,610	$-69,341	$-123,289	$-148,480
Japan	-18,081	-18,966	-21,665	-36,796	-49,749
Canada	-7,263	-13,072	-14,302	-20,387	-22,176
Western Europe	11,001	5,252	-457	-16,902	-27,446
United Kingdom	-876	-2,896	-2,279	-2,834	-4,500
West Germany	-1,641	-3,212	-4,492	-8,726	-12,182
Netherlands	6,075	5,952	4,618	3,224	2,901
France	1,202	1,295	-347	-2,479	-3,864
Belgium-Luxembourg	3,356	2,727	2,539	2,014	1,351
Italy	-189	-1,040	-1,911	-4,129	-5,756
European Community	8,710	3,466	-1,568	-13,291	-22,470
Spain	1,736	1,820	1,078	-66	-250
Switzerland	518	313	408	-636	-1,291
Sweden	43	-403	-968	-1,885	-2,414
Asia (excl. Japan) and Middle East	-17,415	-7,134	-11,518	-26,362	-29,221
Korea	-358	-482	-1,732	-4,044	-4,757
Taiwan	-4,326	-5,220	-7,443	-11,085	-13,061
Saudi Arabia	-7,910	1,166	4,063	1,555	2,447
Singapore	808	940	790	-446	-936
Hong Kong	-3,122	-3,442	-4,261	-5,837	-6,208
Israel	1,241	1,062	717	385	379
India	423	77	-506	-1,167	-836
Malaysia	-735	-223	-521	-969	-860
Philippines	-374	-102	-352	-856	-955
Pakistan	303	519	629	825	743
Thailand	163	-41	28	-313	-694
Indonesia	-5,111	-2,484	-4,191	-4,652	-4,138
Western Hemisphere (excl. Canada)	1,297	-6,012	-17,855	-20,379	-18,076
Mexico	3,776	-3,953	-7,937	-6,275	-5,757
Venezuela	-355	249	-2,362	-3,443	-3,431
Brazil	-1,054	-1,220	-2,825	-5,633	-5,007
Colombia	871	1,020	456	197	12
Africa	-17,030	-8,266	-6,438	-6,169	-5,155
Egypt	1,747	2,306	2,488	2,522	2,239
South Africa	359	320	30	-312	-975
Nigeria	-8,031	-5,979	-3,019	-2,029	-2,432
Australia and Oceania	2,719	2,199	1,473	1,860	2,229
Australia	2,535	1,983	1,532	1,894	2,372
Communist Countries in Asia	1,546	440	-284	-357	-352
China	1,541	410	-304	-377	-368
Eastern Europe	2,640	2,448	1,417	1,836	1,101
Soviet Union	2,030	2,340	1,629	2,684	1,980

Source: Department of Commerce

Table 46: U.S. Exports by Commodity, 1981-1985 (continued)

(in millions of dollars, f.a.s. value basis)

	1981	1982	1983	1984	1985
Nonferrous Metals and Alloys	$2,046	$1,768	$1,606	$1,634	$1,472
Aluminum and Alloys	1,297	1,026	1,010	990	937
Metal Manufactures	4,769	3,981	3,444	3,602	3,253
Machinery and Transport Equipment	95,736	87,148	82,578	89,973	94,278
Machinery	62,946	59,324	54,309	60,318	59,488
Power Generating Machinery	9,465	9,461	8,718	9,114	9,272
Aircraft Engines and Parts	2,348	2,570	2,788	3,011	3,316
Automotive Engines and Parts	1,975	1,955	2,082	2,410	2,494
Agricultural Machinery and Parts	3,523	2,389	1,589	1,740	1,601
Construction Equipment and Parts	1,823	1,254	766	761	820
Mining and Drilling Machinery and Parts		4,905	2,911	2,637	2,922
Textile and Sewing Machinery		554	453	520	498
Printing and Bookbinding Machinery and Parts	729	600	478	465	439
Metalworking Machinery	2,158	1,611	1,121	1,175	1,249
Heating and Cooling Machinery and Parts	2,524	2,291	1,854	1,888	1,791
Pumps and Parts	1,182	1,184	948	962	933
Centrifuges and Filtering and Purifying Machinery and Parts	803	774	734	628	537
Office Machinery and Computers	9,810	10,206	11,669	14,592	14,928
Computers and Parts	5,157	5,349	5,750	7,128	7,197
Telecommunications Equipment	3,856	3,864	3,804	3,943	4,167
Electric Machinery and Parts	11,494	11,285	11,936	13,855	12,489
Electric Power Apparatus	2,495	2,434	2,379	2,790	2,616
Household Appliances	841	673	611	626	551
Transport Equipment	32,791	27,824	28,269	29,655	34,790
Cars	3,920	2,860	4,200	4,868	6,020
Trucks and Buses	2,149	1,765	1,411	1,686	2,183
Car and Truck Parts	3,157	3,039	3,254	3,994	9,376
Tractor Parts	1,481	1,156	972	1,146	1,085
Commercial Aircraft	8,613	4,848	5,691	4,147	6,694
Military Aircraft	1,712	2,388	1,845	1,581	2,012
Aircraft Parts	4,286	4,401	4,526	5,061	5,580
Rail Locomotives and Rolling Stock	488	433	402	584	427
Ships, Boats and Floating Structures	965	1,302	811	221	306
Miscellaneous Manufactured Goods	16,748	15,961	15,246	15,699	15,338
Furniture	697	639	593	622	560
Clothing	1,232	952	818	807	754
Professional, Scientific and Medical Equipment and Measuring and Controlling Instruments	5,980	6,003	5,856	6,198	6,505
Photographic Supplies	1,501	1,396	1,366	1,464	1,313
Printed Material	1,297	1,341	1,324	1,391	1,279
Toys and Sporting Goods	1,072	957	878	674	579
Musical Instruments and Parts	952	942	860	927	898
Unclassified Commodities	8,428	6,924	7,009	10,116	10,971

*Domestic merchandise only, including Department of Defense shipments.

Source: Department of Commerce

Table 46: U.S. Exports by Commodity, 1981-1985

(in millions of dollars, f.a.s. value basis)

	1981	1982	1983	1984	1985
Total Exports*	$228,961	$207,158	$195,969	$212,057	$206,925
Agricultural Commodities	43,338	36,623	36,108	37,813	29,242
Nonagricultural Commodities	185,623	170,535	159,862	174,245	177,684
Food and Live Animals	30,291	23,950	24,166	24,463	19,268
Meat and Meat Products	1,482	1,285	1,191	1,208	1,153
Fish and Fish Products	1,083	995	917	850	1,016
Grain and Cereal Products	19,457	14,747	15,152	16,076	11,050
Wheat	7,844	6,676	6,235	6,477	3,601
Corn	8,014	5,683	6,480	7,081	5,319
Sorghum	1,174	720	731	880	839
Rice	1,526	997	926	845	665
Vegetables and Fruits	3,314	2,716	2,444	2,435	2,377
Animal Feeds	2,739	2,473	2,802	2,226	1,891
Beverages and Tobacco	2,915	3,026	2,813	2,849	2,958
Unmanufactured Tobacco	1,458	1,547	1,462	1,511	1,521
Cigarettes	1,229	1,235	1,126	1,120	1,180
Inedible Crude Materials	20,993	19,248	18,596	20,249	16,940
Hides and Skins	700	778	807	1,171	1,088
Soybeans	6,200	6,240	5,925	5,438	3,906
Rubber	625	553	543	624	584
Logs and Lumber	2,059	2,095	2,104	2,042	2,037
Paper Base Stocks	2,315	1,964	1,916	2,144	1,946
Raw Cotton	2,260	1,955	1,817	2,441	1,633
Steel Scrap	639	610	637	918	917
Nonferrous Ores and Scrap	1,835	1,413	1,456	1,508	1,534
Mineral Fuels	10,279	12,729	9,500	9,311	9,971
Bituminous Coal	5,806	5,934	4,008	4,090	4,398
Petroleum and Products	3,696	5,947	4,557	4,470	4,707
Animal and Vegetable Oils and Fats	1,750	1,541	1,459	1,922	1,434
Inedible Tallow	645	572	525	617	538
Chemicals	21,187	19,891	19,751	22,336	21,759
Chemical Elements and Compounds	9,202	8,541	8,378	9,699	9,290
Organic Chemicals	5,929	5,440	5,326	6,093	6,012
Inorganic Chemicals	3,274	3,101	3,051	3,605	3,278
Pharmaceuticals	2,165	2,275	2,494	2,628	2,708
Fertilizers	1,735	1,386	1,267	1,815	2,160
Plastic Materials	3,809	3,650	3,732	4,050	3,777
Manufactured Goods Classified Chiefly by Material	20,633	16,739	14,852	15,140	14,009
Paper and Paper Products	2,961	2,653	2,553	2,620	2,329
Textiles (excl. clothing)	3,619	2,784	2,368	2,382	2,366
Nonmetallic Mineral Products	2,194	1,805	1,770	1,865	1,821
Steel Mill Products	2,801	2,101	1,415	1,248	1,152

(continued)

Table 47: U.S. Imports by Commodity, 1981-1985

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Total Imports	$273,352	$254,885	$269,878	$341,177	$361,626
Agricultural Commodities	18,590	16,975	18,104	21,522	22,020
Nonagricultural Commodities	254,763	237,910	251,775	319,605	339,607
Food and Live Animals	16,528	15,731	16,692	19,428	20,292
Meat and Meat Products	2,211	2,303	2,241	2,232	2,472
Fish and Fish Products	3,108	3,292	3,764	3,859	4,202
Vegetables and Fruits	2,999	3,279	3,382	4,447	4,619
Sugar	2,295	934	1,113	1,333	1,002
Coffee	2,770	2,888	2,731	3,215	3,284
Beverages and Tobacco	3,418	3,666	3,710	4,007	4,124
Alcoholic Beverages	2,625	2,757	2,876	3,147	3,298
Inedible Crude Materials	12,052	9,302	10,272	11,882	11,167
Crude Rubber	853	607	731	915	746
Lumber	2,114	1,800	2,816	2,952	3,195
Paper Base Stocks	1,842	1,538	1,525	1,907	1,572
Iron Ore and Concentrates	1,123	589	531	628	561
Nonferrous Ores and Concentrates	2,250	1,760	1,449	1,775	1,418
Bauxite	1,431	1,275	1,116	1,350	1,071
Mineral Fuels	84,441	67,657	60,215	63,297	55,843
Petroleum and Petroleum Products	78,506	61,552	54,358	58,167	51,471
Crude Petroleum	64,319	47,446	38,184	37,945	34,124
Petroleum Products	14,187	14,106	16,174	20,222	17,348
Fuel Oil	9,598	8,774	9,410	10,907	8,100
Natural and Manufactured Gas	5,793	6,016	5,748	4,964	4,176
Animal and Vegetable Oils and Fats	524	446	541	742	730
Chemicals	9,882	9,935	11,305	14,401	15,321
Chemical Elements and Compounds	5,584	5,850	6,324	8,093	8,386
Organic Chemicals	3,129	3,109	3,646	4,489	4,833
Inorganic Chemicals	2,455	2,740	2,678	3,603	3,554
Pharmaceuticals	597	576	719	951	1,108
Fertilizers	1,220	1,015	1,056	1,221	1,049
Manufactured Goods Classified Chiefly by Material	39,349	34,997	36,750	49,018	49,499
Tires and Tubes	1,414	1,317	1,503	1,983	2,086
Plywood and Veneers	777	595	826	879	905
Paper and Paper Products	3,974	3,954	4,362	5,822	6,248
Newsprint	2,922	2,803	2,817	3,370	3,720
Textiles (excl. clothing)	3,250	3,000	3,460	4,874	5,274
Cotton Fabrics	637	511	594	935	892
Glass, Glassware and Tableware	1,460	1,467	1,744	2,176	2,406
Gem Diamonds	2,207	1,926	2,283	2,917	3,020

(continued)

Table 47: U.S. Imports by Commodity, 1981-1985 (continued)

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Steel Mill Products	$11,234	$9,918	$6,919	$11,146	$10,614
Wire Rods and Bars	1,921	1,599	1,433	2,053	1,963
Plates and Sheets	3,294	2,774	3,265	4,958	4,615
Tubes, Pipes and Fittings	5,197	4,778	1,497	2,882	2,671
Nonferrous Metals and Alloys	7,078	5,420	7,545	8,350	7,172
Precious Metals	1,591	1,305	2,642	1,916	1,834
Copper and Alloys	1,328	1,023	1,382	1,570	1,195
Nickel and Alloys	869	575	533	608	614
Aluminum and Alloys	1,380	1,364	1,668	2,522	2,066
Metal Manufactures	4,427	4,585	4,807	6,347	7,022
Machinery and Transport Equipment	72,186	75,723	88,928	123,104	141,721
Machinery	39,387	40,564	48,409	70,657	77,717
Power Generating Machinery (incl. engines)	4,681	4,621	5,384	7,465	9,051
Agricultural Machinery and Tractors	1,319	1,073	1,237	1,577	1,499
Textile Machinery	1,011	958	1,098	1,336	1,155
Metalworking Machinery	2,076	1,955	1,540	2,116	2,886
Office Machinery and Computers	3,666	4,412	6,979	11,175	11,917
Telecommunications Equipment	9,178	9,288	11,619	16,423	19,114
Radio Sets	725	736	864	1,056	1,025
Television Sets	1,565	1,462	1,788	2,246	2,327
Stereo Equipment and Audio and Video Cassette Recorders	2,132	2,090	2,756	4,369	6,038
Electrical Machinery and Parts	9,431	10,525	12,828	18,789	18,192
Transport Equipment	32,799	35,159	40,519	52,447	64,003
Road Motor Vehicles	23,194	26,025	29,817	37,830	47,009
Cars	18,395	20,568	23,757	30,147	37,617
Automotive Parts (excl. engines, tires and electrical parts)	4,233	4,486	6,441	9,059	10,568
Motorcycles and Parts	1,441	1,176	838	772	1,014
Aircraft and Parts	2,607	2,511	2,073	3,033	3,600
Miscellaneous Manufactured Goods	27,579	29,631	33,637	45,361	51,684
Clothing	8,008	8,703	10,292	14,513	16,056
Footwear	3,215	3,671	4,291	5,424	6,104
Professional, Scientific and Controlling Instruments	1,700	1,735	1,963	2,770	3,298
Clocks and Watches	1,305	1,015	1,089	1,294	1,406
Printed Matter	656	701	778	1,041	1,175
Toys and Sporting Goods	2,326	2,978	2,702	3,700	4,451
Art Works and Antiques	2,073	2,040	2,033	2,489	2,217
Unclassified Commodities	7,392	7,798	7,830	9,938	11,245

Source: Department of Commerce

Table 48: U.S. Trade with Japan, 1981-1985

(in millions of dollars, seasonally unadjusted)

		Exports* (f.a.s.)	Change Over Year-Earlier Period	Imports (Customs)	Change Over Year-Earlier Period	Trade Balance	Imports (c.i.f.)	Change Over Year-Earlier Period	Trade Balance
1981		$21,823	5.0%	$37,612	22.5%	$-15,789	$39,904	21.0%	$-18,081
1982		20,966	-3.9	37,744	0.4	-16,778	39,932	0.1	-18,966
1983		21,894	4.4	41,183	9.1	-19,289	43,559	9.1	-21,665
1984		23,575	7.7	57,135	38.7	-33,560	60,371	38.6	-36,796
1985		22,631	-4.0	68,783	20.4	-46,152	72,380	19.9	-49,749
1984	January	1,854	15.8	4,614	56.2	-2,760	4,877	55.6	-3,023
	February	1,813	27.3	3,634	25.6	-1,821	3,841	25.1	-2,028
	March	2,028	13.9	4,758	38.3	-2,730	5,023	38.1	-2,995
	April	1,873	6.8	4,638	50.6	-2,765	4,914	50.9	-3,041
	May	1,986	28.4	4,889	41.3	-2,903	5,165	41.1	-3,179
	June	2,031	4.9	4,504	37.1	-2,473	4,758	37.0	-2,727
	July	2,158	12.3	6,260	76.0	-4,102	6,613	75.9	-4,455
	August	1,906	5.9	5,085	39.9	-3,179	5,376	40.0	-3,470
	September	1,768	-9.2	4,940	66.0	-3,172	5,210	65.5	-3,442
	October	1,872	-6.6	5,075	24.7	-3,203	5,357	24.5	-3,485
	November	2,144	2.3	4,588	14.0	-2,444	4,846	13.9	-2,702
	December	2,142	2.7	4,150	9.0	-2,008	4,390	9.1	-2,248
1985	January	2,100	13.3	5,969	29.4	-3,869	6,279	28.7	-4,179
	February	1,824	0.6	4,800	32.1	-2,976	5,063	31.8	-3,239
	March	2,329	14.8	5,725	20.3	-3,396	6,030	20.0	-3,701
	April	1,733	-7.5	5,931	27.9	-4,198	6,235	26.9	-4,502
	May	1,814	-8.7	5,719	17.0	-3,905	6,024	16.6	-4,210
	June	1,751	-13.8	5,824	29.3	-4,073	6,153	29.3	-4,402
	July	1,845	-14.5	5,418	-13.5	-3,573	5,708	-13.7	-3,863
	August	1,743	-8.6	5,444	7.1	-3,701	5,721	6.4	-3,978
	September	1,926	8.9	6,452	30.6	-4,526	6,787	30.3	-4,861
	October	1,834	-2.0	5,237	3.2	-3,403	5,496	2.6	-3,662
	November	1,972	-8.0	6,043	31.7	-4,071	6,342	30.9	-4,370
	December	1,761	-17.8	6,222	49.9	-4,461	6,541	49.0	-4,780

*Domestic and foreign merchandise, including Department of Defense shipments.

Source: Department of Commerce

Table 49: U.S. Exports to Japan by Commodity, 1981-1985

(in millions of dollars, f.a.s. value basis)

	1981	1982	1983	1984	1985
Total Exports to Japan*	$21,515	$20,665	$21,520	$23,094	$22,042
Agricultural Commodities	6,562	5,547	6,241	6,757	5,394
Nonagricultural Commodities	14,953	15,118	15,279	16,337	16,648
Food and Live Animals	4,712	3,944	4,294	4,705	4,011
Meat and Meat Products	502	530	574	571	541
Fish and Fish Products	553	600	506	503	685
Grain and Cereal Products	2,876	2,107	2,493	2,873	2,044
Wheat	615	564	589	534	469
Corn	1,792	1,290	1,764	1,999	1,305
Sorghum	410	208	86	270	243
Vegetables and Fruits	445	401	419	453	452
Animal Feeds	152	140	159	173	161
Beverages and Tobacco	392	400	442	399	417
Unmanufactured Tobacco	302	310	339	286	302
Cigarettes	74	67	80	95	95
Inedible Crude Materials	4,407	4,054	4,185	4,452	3,951
Hides and Skins	281	228	240	325	298
Synthetic Rubber	41	49	47	57	51
Soybeans	1,139	971	1,210	1,173	938
Logs and Lumber	1,021	1,045	900	841	885
Paper Base Stocks	549	488	485	528	476
Raw Cotton	504	501	500	605	368
Steel Scrap	118	145	218	265	199
Nonferrous Ores and Scrap	503	367	309	364	460
Mineral Fuels	2,097	2,440	1,994	1,812	1,782
Bituminous Coal	1,472	1,525	1,002	865	769
Petroleum Products	291	621	639	683	762
Animal and Vegetable Oils and Fats	91	83	62	53	51
Chemicals	2,349	2,530	2,607	2,961	2,908
Chemical Elements and Compounds	1,215	1,303	1,308	1,553	1,506
Organic Chemicals	686	665	674	717	704
Inorganic Chemicals	529	638	634	836	802
Pharmaceuticals	430	489	521	553	570
Fertilizers	65	96	110	122	124
Plastic Materials	290	308	345	372	324

(continued)

Table 49: U.S. Exports to Japan by Commodity, 1981-1985 (continued)

(in millions of dollars, f.a.s. value basis)

	1981	1982	1983	1984	1985
Manufactured Goods Classified Chiefly by Material	$1,394	$1,320	$1,360	$1,403	$1,244
Paper and Paper Products	260	263	294	294	295
Textiles (excl. clothing)	124	106	98	113	108
Nonmetallic Mineral Products	127	117	136	152	150
Iron and Steel	44	46	42	63	48
Nonferrous Metals and Alloys	443	447	413	379	289
Copper and Alloys	22	10	24	119	16
Aluminum and Alloys	399	416	375	226	258
Metal Manufactures	151	174	191	207	174
Machinery and Transport Equipment	4,405	4,090	4,794	5,223	5,751
Machinery	2,902	3,015	3,251	3,897	3,805
Power Generating Machinery	342	331	517	617	444
Aircraft Engines and Parts	150	177	180	218	295
Mining and Drilling Machinery and Parts	168	254	89	70	69
Metalworking Machinery	94	90	68	77	84
Heating and Cooling Equipment	88	78	80	79	91
Centrifuges and Filtering and Purifying Machinery and Parts	67	62	58	48	49
Office Machinery and Computers	759	838	905	1,115	1,307
Computers and Parts	402	408	461	590	676
Telecommunications Equipment	182	174	208	206	241
Electrical Machinery and Parts	601	618	738	930	824
Electric Power Apparatus and Switchgear	120	121	141	173	163
Transport Equipment	1,504	1,075	1,543	1,327	1,946
Road Motor Vehicles and Parts	173	148	145	191	214
Automotive Parts	25	24	36	34	130
Aircraft and Parts	1,310	906	1,345	1,073	1,710
Commercial Aircraft	815	421	835	541	906
Aircraft Parts	487	468	498	519	574
Miscellaneous Manufactured Goods	1,377	1,410	1,367	1,479	1,483
Clothing	85	65	44	43	34
Professional, Scientific and Medical Equipment and Measuring and Controlling Instruments	537	549	583	645	691
Photographic Supplies	206	202	221	225	219
Printed Material	47	52	55	66	60
Toys and Sporting Goods	118	162	114	89	80
Musical Instruments and Parts	92	85	82	91	93
Unclassified Commodities	111	96	121	204	443

*Domestic merchandise only, including Department of Defense shipments.

Source: Department of Commerce

Table 50: U.S. Imports from Japan by Commodity, 1981-1985

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Total Imports from Japan	$39,904	$39,932	$43,559	$60,371	$72,380
Agricultural Commodities	132	142	186	243	269
Nonagricultural Commodities	39,772	39,789	43,373	60,129	72,111
Food and Live Animals	287	301	366	436	488
Fish and Fish Products	199	206	236	265	297
Beverages and Tobacco	17	19	28	39	39
Inedible Crude Materials	67	62	81	94	120
Mineral Fuels	27	23	12	59	67
Animal and Vegetable Oils and Fats	6	6	7	8	9
Chemicals	1,021	937	1,172	1,403	1,506
Chemical Elements and Compounds	534	496	584	673	731
Organic Chemicals	441	391	459	548	599
Inorganic Chemicals	93	105	125	125	132
Pharmaceuticals	81	70	84	78	87
Manufactured Goods Classified Chiefly by Material	7,520	7,348	5,667	7,872	8,222
Tires and Tubes	413	415	455	583	630
Plywood and Veneers	53	38	47	48	42
Paper and Paper Products	63	59	78	99	130
Textiles (excl. clothing)	541	557	620	717	764
Yarn	45	54	73	93	77
Cotton Fabrics	49	58	70	119	152
Other Fabrics	331	322	347	350	362
Glass, Glassware and Tableware	436	385	452	532	580
Steel Mill Products	4,143	3,855	2,117	3,453	3,344
Wire Rods and Bars	559	442	376	553	506
Plates and Sheets	997	832	1,103	1,739	1,564
Tubes, Pipes and Fittings	2,430	2,410	462	864	971
Nonferrous Metals and Alloys	329	327	411	531	561
Copper and Alloys	109	83	113	121	115
Aluminum and Alloys	49	185	233	346	363
Metal Manufactures	1,227	1,447	1,179	1,457	1,689

(continued)

Table 50: U.S. Imports from Japan by Commodity, 1981-1985 (continued)

(in millions of dollars, c.i.f. value basis)

	1981	1982	1983	1984	1985
Machinery and Transport Equipment	$27,010	$27,169	$31,783	$44,662	$54,842
Machinery	12,282	12,785	15,924	25,535	29,642
Power Generating Machinery (incl. engines)	724	749	880	1,332	1,510
Agricultural Machinery and Tractors	195	196	246	373	422
Textile Machinery	204	166	205	258	257
Metalworking Machinery	822	768	641	937	1,306
Office Machinery and Computers	1,284	2,176	3,389	5,454	5,843
Telecommunications Equipment	4,901	4,818	5,856	9,125	11,549
Radio Sets	279	263	254	295	316
Television Sets	457	442	435	706	851
Stereo Equipment and Audio and Video Cassette Recorders	1,796	1,747	2,400	3,839	5,368
Electric Machinery	2,051	2,276	3,026	5,079	4,915
Transport Equipment	14,727	14,384	15,859	19,127	25,200
Road Motor Vehicles	12,428	12,269	13,756	16,244	21,669
Cars	10,045	9,834	10,963	13,038	17,126
Automotive Parts (excl. engines, tires and electrical parts)	531	616	931	1,622	2,125
Motorcycles and Parts	1,361	1,125	785	699	940
Aircraft and Parts	134	167	143	133	134
Miscellaneous Manufactured Goods	3,613	3,641	4,069	5,383	6,327
Clothing	292	269	361	527	519
Professional, Scientific and Controlling Instruments	431	435	531	794	977
Clocks and Watches	426	312	343	447	490
Printed Matter	87	92	108	148	166
Toys and Sporting Goods	338	484	322	416	592
Unclassified Commodities	338	425	374	416	760

Source: Department of Commerce

Table 51: U.S. Exports to Japan by End-Use Classification, 1984-1985

(in millions of dollars, f.a.s. value basis, and indicated quantity units)

Commodity	Quantity - 1984	Quantity - 1985	Value 1984	Value 1985	Percent Change 1984/85	Japan's Share of U.S. Exports 1985
Total Exports			$23,575.0	$22,630.8	-4.0%	10.6%
Industrial Supplies			9,139.2	8,679.9	-5.0	14.8
Bituminous Coal	16,324,191 stn	15,370,720 stn	865.4	769.1	-11.1	17.5
Coking Coal	15,498,931 stn	13,903,308 stn	829.8	712.9	-14.1	23.4
Steam Coal	825,260 stn	1,467,412 stn	35.7	56.2	57.4	4.1
Petroleum Products			683.1	762.0	11.6	21.2
Light Fuel Oils	3,175,817 bbl	2,534,194 bbl	102.6	74.8	-27.1	11.0
Heavy Fuel Oils	13,579,993 bbl	17,423,590 bbl	369.2	432.6	17.2	24.9
Petroleum Coke (excl. calcined)	3,056,909 stn	3,456,521 stn	120.1	157.2	30.9	33.3
Natural Gas	55,618,275 mcf	54,174,547 mcf	262.3	249.1	-5.0	99.5
Nuclear Reactor Fuels			144.1	121.5	-15.7	35.3
Logs and Lumber	2,361,936 mbf	2,523,343 mbf	840.5	884.9	5.3	43.4
Logs	1,759,738 mbf	1,899,035 mbf	641.0	682.2	6.4	54.1
Douglas-fir Logs	914,927 mbf	1,019,640 mbf	325.6	361.7	11.1	60.6
Western Hemlock Logs	631,475 mbf	679,058 mbf	199.1	209.5	5.2	54.9
Lumber	602,198 mbf	624,308 mbf	199.5	202.7	1.6	27.0
Paper Base Stocks			519.9	470.2	-9.6	24.8
Wood Chips	2,191,675 stn	2,169,430 stn	156.6	160.6	2.6	95.1
Wood Pulp	737,697 stn	752,901 stn	327.2	277.6	-15.2	20.5
Paper and Paper Products			290.0	288.9	-0.4	13.1
Newsprint	182,620 stn	181,412 stn	86.8	81.6	-6.0	62.1
Kraft Linerboard	164,727 stn	150,149 stn	50.5	38.5	-23.8	8.0
Coated Container Base Stock	130,004 stn	137,127 stn	90.4	97.5	7.9	52.8
Chemicals (excl. plastics, fertilizers and insecticides)			1,536.8	1,513.2	-1.5	14.3
Cyclic Hydrocarbons			80.6	59.2	-26.6	8.5
Cyclic Organic Intermediate Chemical Compounds			142.8	143.2	0.3	11.3
Alcohols, Phenols and Their Derivatives			40.9	57.5	40.6	30.3
Acyclic Organic Chemical Products			340.4	350.0	2.8	15.2
Ethylene Dichloride	247,659 stn	328,939 stn	52.3	58.8	12.4	64.8
Uranium and Thorium Compounds	561 stn	776 stn	437.7	437.5	-0.1	45.0
Sodium Compounds			49.2	51.1	3.9	8.7
Antiknock Compounds and Additives for Lubricating Oils			68.1	67.5	-0.9	10.4
Fertilizers and Insecticides			297.7	276.9	-7.0	6.9
Crude Phosphates	1,404,789 stn	777,625 stn	50.8	27.3	-46.3	14.0
Fertilizers			122.2	124.1	1.6	5.7
Diammonium Phosphate Fertilizers	538,275 stn	267,205 stn	92.2	42.9	-53.5	6.7
Unmixed Pesticides			44.1	66.1	49.9	8.8
Manufactured Pesticides			65.4	60.0	8.3	9.8
Plastic and Synthetic Resin Compounds			356.5	305.6	-14.3	8.8
Synthetic Rubber			56.9	51.0	-10.4	8.7
Steel Scrap	2,680,038 stn	2,110,087 stn	264.9	199.1	-24.8	21.7
Nonferrous Ores and Scrap			363.8	459.6	26.3	30.0
Copper Ore	62,004 stn	113,354 stn	63.7	108.9	71.0	83.1
Aluminum Scrap	188,051 stn	290,591 stn	184.3	243.7	32.2	69.5
Nonferrous Metals			378.9	289.4	-23.6	19.7
Platinum and Platinum Group Metals	234,766 toz	185,665 toz	67.0	62.7	-6.4	56.9
Copper and Copper Alloys			119.2	16.3	-86.3	5.4
Unwrought Copper	78,567 stn	5,605 stn	107.5	7.9	-92.7	11.2
Aluminum and Aluminum Alloys			226.0	257.7	14.0	27.5
Aluminum Ingot	154,011 stn	218,620 stn	209.9	239.2	14.0	54.2

(continued)

Table 51: U.S. Exports to Japan by End-Use Classification, 1984-1985 (continued)

(in millions of dollars, f.a.s. value basis, and indicated quantity units)

Commodity	Quantity 1984	Quantity 1985	Value 1984	Value 1985	Percent Change 1984/85	Japan's Share of U.S. Exports 1985
Iron and Steel (incl. ferroalloys)			$63.1	$48.4	-23.3%	3.9%
Unmanufactured Nonmetallic Minerals			100.4	104.8	4.4	14.2
Kaolin Clay	468,450 stn	437,244 stn	61.7	60.2	-2.4	34.5
Manufactured Mineral Supplies			108.7	111.1	2.2	8.3
Industrial Textile Fibers, Yarns and Fabrics			67.5	69.3	2.7	2.8
Raw Cotton	1,588,117 rba	1,065,454 rba	605.1	368.0	-39.2	22.5
Hides and Skins			325.2	298.2	-8.3	27.4
Whole Cattle Hides	7,333,641 pc	6,824,464 pc	305.0	276.1	-9.5	27.8
Leaf Tobacco	46,058 stn	51,002 stn	286.0	302.4	5.7	19.9
Stemmed Flue-Cured Leaf	34,036 stn	31,897 stn	243.5	211.3	-13.2	23.8
Stemmed Burley Leaf	5,460 stn	11,266 stn	40.7	83.2	104.4	27.2
Capital Goods			5,626.6	5,938.6	5.5	6.1
Nonelectric Machinery			3,458.5	3,384.7	-2.1	7.4
Data Processing Equipment			1,166.2	1,331.1	14.1	9.2
Computers			296.6	383.2	29.2	12.2
Peripheral Equipment and Parts			760.2	866.7	14.0	8.1
Disk and Tape Storage Units			85.3	74.4	-12.8	5.5
Parts			484.5	585.3	20.8	8.7
Semiconductor Production and Assembly Equipment and Parts			351.6	276.4	-21.4	25.0
Measuring, Testing and Controlling Instruments and Parts			539.1	553.2	2.6	11.2
Industrial Process-Type Instruments and Parts			56.1	45.9	-18.2	6.3
Chemical Analysis Equipment and Parts			51.5	59.7	15.9	12.4
Physical Analysis Equipment and Parts			55.6	50.5	-9.2	12.7
Equipment for Testing Electrical, Radio and Communications Circuits and Parts			191.6	216.5	13.0	16.4
Instruments for Measuring or Testing Combinations of Electrical Characteristics and Parts			78.8	95.9	21.7	19.9
Scientific, Professional and Medical Equipment			247.1	265.5	7.4	12.1
Electromedical and Electrotherapeutic Apparatus and Parts (excl. X-ray apparatus)			110.6	117.5	6.2	13.2
Other Medical, Dental and Surgical Instruments and Parts			86.4	91.6	6.0	11.4
Power Generating Equipment (excl. aircraft and automotive engines)			307.5	73.3	-76.2	3.6
Auxiliary Plant for Steam and Other Vapor Generating Boilers			85.1	0.5	-99.4	2.3
Gas Turbines and Parts for Mechanical Drives			123.0	17.0	-86.2	3.3
Nonfarm Tractors, Parts and Attachments			45.3	52.4	15.7	3.2
Drilling and Oilfield Equipment			66.9	68.9	3.0	2.2
Parts and Accessories for Oilfield and Gasfield Drilling Equipment			63.5	63.1	-0.6	2.6
Machine Tools and Parts			56.1	59.8	6.6	7.9
Equipment for Service Industries			111.3	120.1	7.9	6.4
Electric Machinery			874.9	804.3	-8.1	5.9
Semiconductors			361.5	235.1	-35.0	5.6
Integrated Circuits			253.7	130.6	-48.5	11.5
Linear Integrated Circuits			81.8	33.6	-58.9	15.7
Chips, Dice and Wafers			69.2	75.7	9.4	3.4
Radar Apparatus (excl. for planes and boats) and Parts			63.5	70.8	11.5	12.5
Parts			58.8	67.7	15.1	14.8
Generators, Transformers and Accessories			92.3	75.9	-17.8	5.0
Connectors			57.4	46.8	-18.5	13.2

(continued)

Table 51: U.S. Exports to Japan by End-Use Classification, 1984-1985 (continued)

(in millions of dollars, f.a.s. value basis, and indicated quantity units)

Commodity	Quantity 1984	Quantity 1985	Value 1984	Value 1985	Percent Change 1984/85	Japan's Share of U.S. Exports 1985
Transportation Equipment			$1,293.2	$1,749.6	35.3%	4.7%
Civilian Aircraft			541.4	905.9	67.3	13.5
Passenger, Cargo and Combination Jet Transports	10 ut	17 ut	461.6	886.4	92.0	16.1
Civilian Aircraft Engines, Parts and Accessories			437.5	552.1	26.2	8.8
Jet Turbines			56.0	50.3	-10.2	5.7
Jet Engine Parts			158.6	229.4	44.6	11.7
Parts for Civilian Aircraft			227.1	270.2	19.0	8.5
Railway Equipment, Parts and Accessories			55.7	11.9	-78.6	2.8
Automotive Parts, Engines and Bodies			180.2	214.8	19.2	1.5
Food and Feed			5,929.2	5,000.7	-15.7	21.9
Corn (excl. seed and popcorn)	537,086,560 bu	432,179,039 bu	1,990.2	1,292.6	-35.1	25.0
Sorghum (excl. seed)	87,897,756 bu	95,506,830 bu	269.1	240.9	-10.5	29.9
Soybeans (excl. seed)	152,067,433 bu	157,900,636 bu	1,171.7	937.0	-20.0	24.1
Animal Feeds			172.7	161.2	-6.7	8.5
Dried Beet Pulp	444,437 stn	359,546 stn	58.2	43.9	-24.6	84.9
Alfalfa Hay Cubes	396,409 stn	441,397 stn	51.4	56.8	10.5	90.7
Wheat	124,086,660 bu	114,652,413 bu	534.5	469.0	-12.3	13.3
Fruits and Vegetables			452.6	452.1	-0.1	19.0
Lemons	132,380 stn	120,988 stn	80.4	77.2	-4.0	83.2
Grapefruit	159,517 stn	118,701 stn	51.4	51.5	0.2	55.7
Oranges and Tangerines	96,203 stn	119,097 stn	62.0	73.3	18.2	30.3
Frozen Vegetables			59.5	61.0	2.5	65.0
Meat and Meat Products			571.0	540.8	-5.3	46.9
Fresh and Frozen Beef	85,578 stn	91,012 stn	322.2	340.6	5.7	75.0
Fresh and Frozen Beef Offals	38,072 stn	40,133 stn	76.9	76.1	-1.0	30.6
Fresh and Frozen Pork	20,845 stn	10,118 stn	62.1	32.7	-47.3	52.9
Fresh and Frozen Poultry	57,647 stn	51,158 stn	74.6	57.3	-23.2	25.5
Fish and Fish Products			502.9	685.4	36.3	67.5
Fresh and Frozen Whole Salmon	84,910 stn	113,657 stn	261.5	384.9	47.2	83.3
Fresh and Frozen Whole Herring	33,154 stn	37,245 stn	42.9	54.7	27.5	77.5
Fish Roe	15,196 stn	14,042 stn	81.4	99.5	22.2	83.8
Consumer Goods			1,475.5	1,415.5	-4.1	11.2
Pharmaceuticals			571.8	590.5	3.3	20.8
Bulk Antibiotics			163.8	167.7	2.4	24.8
Blood and Blood Derivatives			146.3	161.5	10.4	43.2
Cigarettes	315,258,900 pk	322,756,950 pk	95.4	94.9	-0.5	8.0
Stainless Steel Cooking and Kitchenware			77.1	39.0	-49.4	76.9
Toys and Sporting Goods			90.6	85.7	-5.4	11.7
Still Film in Cartridges and Rolls	44,567,790 ut	39,890,112 ut	64.0	57.4	-10.3	24.8
Gem Diamonds and Other Gem Stones			56.3	50.3	-10.7	11.3
Printed Material			66.0	59.7	-9.5	4.7
Miscellaneous			1,404.5	1,595.9	13.6	7.5
Military-Type Goods			401.6	439.0	9.3	8.1
Other Domestic Exports			521.6	568.2	8.9	5.9
Military Aircraft Engine Parts			326.3	334.2	2.4	11.9
Re-exports			481.3	588.8	22.3	9.5

Key to quantity abbreviations: bbl = barrels; bu = bushels; mbf = thousand board feet; mcf = thousand cubic feet; pc = pieces; pk = packs; rba = running bales; stn = short tons; toz = troy ounces; ut = units

Source: Department of Commerce

Table 52: U.S. Imports from Japan by End-Use Classification, 1984-1985

(in millions of dollars, Customs value basis, and indicated quantity units)

Commodity	Quantity 1984	Quantity 1985	Value 1984	Value 1985	Percent Change 1984/85	Japan's Share of U.S. Imports 1985
Total Imports			$57,135.0	$68,782.9	20.4%	19.9%
Automotive Products			18,902.9	24,980.0	32.1	37.4
Cars	1,950,406 no	2,527,467 no	12,349.9	16,231.3	31.4	44.5
Assembled Trucks	566,283 no	803,965 no	2,349.3	3,408.6	45.1	47.4
Automotive Parts, Accessories and Engines			3,631.6	4,429.5	22.0	22.0
Body Stampings			119.5	155.5	30.1	48.1
Transmissions			155.2	252.2	62.5	20.2
Engines and Parts			617.7	652.4	5.6	16.2
Engines	479,852 no	576,472 no	461.5	463.7	0.5	5.4
Parts			156.2	188.8	20.9	20.1
Starting and Ignition Equipment			134.2	165.9	23.6	42.8
Tires			426.0	467.2	9.7	29.5
Car Tires	6,433,383 no	8,027,564 no	171.5	207.7	21.1	24.1
Truck and Bus Tires	2,091,858 no	2,539,960 no	254.5	259.5	2.0	36.1
Golf Carts, Mopeds and Similar Vehicles	548,410 no	743,539 no	478.6	726.3	51.8	94.3
Capital Goods			19,289.6	21,515.7	11.5	33.1
Nonelectric Machinery			12,891.9	14,448.9	12.1	36.2
Business Machines			6,414.6	6,274.1	-2.2	46.0
Office Typewriters	632,040 no	393,594 no	166.3	101.7	-38.8	55.0
Calculators	21,357,889 no	20,431,856 no	276.3	278.3	0.7	71.5
Cash Registers (excl. point-of-sale units)	396,024 no	431,156 no	97.0	108.3	11.6	97.3
Photocopiers and Parts			907.9	1,137.7	25.3	83.3
Photocopiers	762,703 no	897,676 no	723.3	892.8	23.4	82.9
Parts			184.6	244.9	32.7	84.5
Data Processing Equipment and Parts			3,185.4	3,233.6	1.5	39.9
Data Processing Equipment			1,873.4	1,924.9	2.7	48.1
Parts			1,312.1	1,308.7	-0.3	31.9
Machine Tools and Parts			776.2	975.8	25.7	46.1
Numerically Controlled Lathes	2,889 no	3,765 no	173.8	220.3	26.8	86.2
Machining Centers	2,813 no	3,860 no	238.1	306.7	28.8	90.0
Parts			78.7	109.9	39.6	29.5
Casting Machines Used in Metallurgy and Parts			15.6	112.5	621.2	48.3
Farm Tractors	60,383 no	72,264 no	247.3	280.5	13.4	85.7
Under 40 Horsepower	50,722 no	58,807 no	183.0	214.7	17.3	82.1
Excavating Machinery and Parts			368.1	508.1	38.0	39.3
Front-End Loaders	3,314 no	4,742 no	148.4	208.1	40.2	41.8
Forklifts and Other Self-Propelled Work Trucks and Parts	28,495 no	34,426 no	231.3	274.1	18.5	50.3
Materials Handling Equipment and Parts			151.1	180.2	19.3	21.5
Textile Machinery and Parts			174.7	176.2	0.9	22.5
Printing Equipment and Parts			134.9	181.3	34.4	25.6
Machinery and Parts for Making Plastics and Rubber			65.6	105.1	60.2	25.0
Airconditioning Machinery and Parts			101.5	168.9	66.4	70.9
Compressors and Parts			260.8	344.9	32.2	52.3
Over 1 Horsepower	2,393,572 no	3,114,718 no	112.9	153.7	36.1	90.5
Power Hand Tools			164.3	187.6	14.2	48.6
Electric Hand Tools			101.4	135.0	33.1	57.5
Tools for Hand or Machine Use			120.0	162.4	35.3	22.5
Bearings and Parts			288.9	299.4	3.6	46.7
Radial Ball Bearings			113.8	119.7	5.2	49.3
Tapered Roller Bearings and Parts			112.3	100.8	-10.2	73.0

(continued)

Table 52: U.S. Imports from Japan by End-Use Classification, 1984-1985 (continued)

(in millions of dollars, Customs value basis, and indicated quantity units)

Commodity	Quantity		Value		Percent Change	Japan's Share of U.S. Imports
	1984	1985	1984	1985	1984/85	1985
Taps, Cocks, Valves and Similar Devices and Parts			$110.4	$186.9	69.3%	21.9%
Small Stationary Diesel Engines and Parts			118.5	110.7	-6.6	22.7
Small Stationary Gas Engines and Parts			111.5	161.1	44.5	57.8
Electromechanical Apparatus and Parts			114.1	151.9	33.1	28.8
X-Ray Apparatus and Parts			57.7	85.7	48.5	16.5
Medical, Dental and Veterinary Instruments and Parts			127.3	154.5	21.4	35.1
Optical Instruments (excl. electro-optical)			76.4	88.4	15.7	74.0
Astronomical Instruments and Parts			89.5	113.1	26.4	72.6
Nonelectric Measuring and Controlling Instruments and Parts			100.7	163.5	62.4	30.5
Electric Measuring and Controlling Instruments and Parts			328.0	403.4	23.0	26.0
Instruments for Checking or Measuring Electrical Quantities			104.8	119.4	13.9	41.1
Film Processing and Printing Equipment			77.9	106.4	36.6	57.0
Magnetic Media			542.9	761.6	40.3	71.0
Blank Audio Cassettes	66,671,006 no	70,235,346 no	76.8	80.7	5.1	52.6
Blank Video Cassettes	61,886,607 no	123,539,802 no	267.7	397.5	48.5	79.0
Other Blank Video Recording Media			91.3	131.8	44.4	83.3
Electric Machinery			6,029.4	6,542.6	8.5	34.5
Semiconductors			1,843.6	1,205.7	-34.6	22.1
Discrete Devices			318.8	326.3	2.4	30.3
Transistor Parts			206.0	217.9	5.8	40.2
Integrated Circuits			1,524.8	879.4	-42.3	20.1
Digital Bipolar Chips			130.0	93.2	-28.3	9.6
Digital Metal Oxide on Silicon Chips	311,431,437 no	201,655,545 no	1,282.1	699.8	-45.4	26.9
Chips, Dice and Wafers			149.8	119.8	-20.0	45.2
Printed Circuit Boards	10,075,647 no	9,359,894 no	78.9	81.0	2.7	27.7
Capacitors			152.1	121.2	-20.3	35.6
Microphones, Loudspeakers and Amplifers and Parts			453.1	589.2	30.0	61.1
Loudspeakers	28,874,575 no	45,921,410 no	180.3	256.9	42.5	69.0
Audiofrequency Amplifiers	2,161,254 no	3,193,381 no	140.2	212.2	51.4	75.3
Television Cameras and Parts	846,612 no	791,827 no	483.7	426.0	-11.9	95.8
Radio Transceivers (excl. citizens' band)	606,711 no	618,314 no	125.5	129.6	3.3	51.0
Radiotelephonic Apparatus and Parts			265.6	279.9	5.4	33.9
Telephone Apparatus and Parts			730.4	735.2	0.7	46.7
Telephone Switching Equipment and Parts			319.7	205.2	-35.8	39.2
Telephone Instruments	3,125,916 no	2,507,509 no	184.8	404.3	118.8	48.6
Teleprinting and Teletypewriting Machines and Parts			115.8	52.5	-54.7	68.5
Telegraph Apparatus and Instruments and Parts			100.7	298.6	196.5	74.9
Switchgear			426.4	468.5	9.9	26.9
Switches			199.1	202.1	1.5	34.9
Relays			87.8	83.0	-5.5	43.1
Rectifiers and Rectifying Equipment			79.3	114.7	44.6	21.1
Resistors			101.8	82.9	-18.6	34.3
Electric Motors and Generators			188.9	179.6	-4.9	23.9
Electric Motors Under 1/40 Horsepower	13,672,910 no	12,859,644 no	92.6	83.6	-9.7	56.2
Welding Equipment and Parts			69.3	102.8	48.3	42.4
Batteries and Parts (excl. lead-acid batteries)			103.0	130.0	26.2	49.0
Permanent Magnets and Magnetic Workholders			59.9	79.3	32.4	46.1
Electric Signalling Apparatus and Parts			137.8	163.2	18.4	30.6
Transport Equipment			368.3	524.2	42.3	8.4
Aircraft Parts			120.6	375.7	211.5	9.1
Self-Propelled Rail Vehicles	232 no	94 no	150.3	49.5	-67.1	53.0

(continued)

Table 52: U.S. Imports from Japan by End-Use Classification, 1984-1985 (continued)

(in millions of dollars, Customs value basis, and indicated quantity units)

Commodity	Quantity		Value		Percent Change	Japan's Share of U.S. Imports
	1984	1985	1984	1985	1984/85	1985
Consumer Goods			$11,265.6	$14,017.2	24.4%	20.5%
Color Video Cassette Recorders	9,306,563 no	15,754,990 no	2,838.1	4,084.8	43.9	97.0
Video Tape Players	144,631 no	195,485 no	69.5	81.1	16.7	95.8
Assembled Color Television Receivers	1,405,422 no	1,808,721 no	350.0	477.9	36.5	43.5
Television Combinations			29.3	136.8	366.9	39.9
Unassembled Television Receivers and Incomplete Subassemblies			271.6	285.0	4.9	51.2
Television Picture Tubes and Parts			89.5	113.4	26.7	54.2
Parts for Television Receivers			656.1	649.6	-1.0	45.2
Converters, Preamplifiers, Amplifiers and Couplings for Cable Television			247.4	307.8	24.4	51.3
AM and AM/FM Radio Receivers (except for motor vehicles)	4,427,759 no	5,502,110 no	239.9	264.8	10.4	41.7
Radio-Tape Recorder Combinations	5,072,540 no	5,731,264 no	286.4	278.8	-2.7	41.4
Radio-Tape Player Combinations	10,132,064 no	11,220,463 no	574.3	675.7	17.7	50.2
Radio-Phonograph-Tape Recorder Combinations	614,032 no	646,504 no	69.7	225.8	224.0	86.9
Audio Tape Players	5,541,892 no	5,084,910 no	124.2	121.4	-2.3	61.5
Audio Tape Receivers and Dictation Machines and Parts			570.1	631.7	10.8	66.6
Other Tape Recorder and Tape Player Combinations			56.3	142.7	153.5	41.5
Record Players and Turntables and Parts	2,836,044 no	4,624,959 no	213.9	373.8	74.8	88.0
Electric Appliances and Parts			641.7	808.5	26.0	35.9
Microwave Ovens	1,731,868 no	3,601,307 no	264.9	407.4	53.8	54.8
Electric Stoves and Ranges and Parts			195.1	172.2	-11.7	89.1
Portable Typewriters	1,138,201 no	1,421,237 no	99.3	120.6	21.5	68.2
Earthen and China Tableware and Household Articles			367.9	392.0	6.6	39.8
Nonbone China Tableware	173,427,516 pc	195,497,796 pc	149.3	149.4	0.1	41.8
Earthen Tableware	268,660,860 pc	332,884,500 pc	156.7	177.2	13.1	56.8
Table Flatware and Kitchen Knives			115.5	106.6	-7.7	41.2
Variable Focus Still Cameras	5,219,265 no	5,218,913 no	528.4	489.6	-7.3	86.9
Mounted Photographic Lenses	7,947,964 no	5,613,419 no	174.6	158.2	-9.4	78.6
Optical Elements			92.6	107.0	15.6	30.9
Clocks and Watches and Parts			435.6	476.2	9.3	34.9
Other Watches Without Balance Wheel and Hairspring	9,660,652 no	14,815,614 no	249.6	305.6	22.4	44.2
Toys and Sporting Goods			412.2	563.8	36.8	14.9
Toys			112.1	257.1	129.3	14.9
Rubber or Plastic Toys			17.5	126.2	621.1	30.9
Video Games and Parts			95.0	77.5	-18.4	56.3
Fishing Equipment			67.6	81.0	19.8	36.4
Musical Instruments and Parts			196.6	293.7	49.4	56.2
Electronic Musical Instruments			91.5	175.7	92.0	84.4
Motorcycles and Parts (excl. engines)			661.5	883.8	33.6	92.6
Motorcycles	411,997 no	710,674 no	447.2	693.7	55.1	93.4
Motorcycles with Piston Displacement Over 290 cc	187,826 no	239,129 no	322.4	418.3	29.7	93.1
Parts (excl. engines)			214.3	190.1	-11.3	90.0
Adult Bicycles and Parts			140.2	124.1	-11.5	35.1
Outboard Motors	100,692 no	157,450 no	71.4	129.1	80.8	77.8
Clothing and Accessories			494.0	487.3	-1.4	3.3
Women's Cotton Slacks	10,103,280 no	11,099,292 no	69.5	78.8	13.4	13.1
Pearls (not set or strung)			215.2	200.4	-6.9	86.7
Printed Material			133.5	153.1	14.7	13.7
Pens and Pencils			96.8	109.4	13.0	62.3
Pharmaceuticals			138.4	165.5	19.6	9.3
Benzenoid Drugs			59.0	75.8	28.5	10.7

(continued)

Table 52: U.S. Imports from Japan by End-Use Classification, 1984-1985 (continued)

(in millions of dollars, Customs value basis, and indicated quantity units)

Commodity	Quantity		Value		Percent Change	Japan's Share of U.S. Imports
	1984	1985	1984	1985	1984/85	1985
Intermediate Goods			$6,849.6	$7,035.3	2.7%	6.2%
Steel Mill Products	6,630,005 stn	5,990,077 stn	3,149.9	3,048.3	-3.2	31.4
Wire Rods and Bars	1,319,378 stn	1,190,072 stn	495.1	453.1	-8.5	25.5
Unalloyed Wire Rods	282,183 stn	236,553 stn	107.3	84.7	-21.1	22.0
Semifinished Angles, Shapes and Sections Over 3"	711,502 stn	669,259 stn	215.7	202.3	-6.2	33.8
Plates and Sheets	3,315,994 stn	2,945,492 stn	1,597.8	1,430.3	-10.5	33.8
Tin Plate and Tin-Coated Sheets	211,071 stn	253,122 stn	120.7	137.2	13.7	63.5
Coated Plates and Sheets	1,683,098 stn	1,492,082 stn	817.9	748.0	-8.5	55.5
Unalloyed Non-Pickled Plates and Pickled Sheets	285,145 stn	214,634 stn	95.2	72.0	-24.4	9.1
Unalloyed Cold-Rolled Sheets	830,497 stn	624,185 stn	329.5	257.7	-21.8	27.4
Strip	65,720 stn	72,072 stn	71.0	82.0	15.5	30.3
Rails	193,868 stn	210,896 stn	69.2	83.5	20.7	65.3
Wire (excl. flat wire and insulated electric wire)	184,694 stn	140,617 stn	121.4	100.8	-17.0	25.3
Unalloyed and Uncoated Wire	137,235 stn	94,322 stn	76.4	54.5	-28.7	32.8
Tubes, Pipes and Fittings	1,405,798 stn	1,425,788 stn	788.4	889.6	12.8	36.4
Unalloyed Welded or Seamless API Line Pipe	238,058 stn	271,457 stn	91.2	114.5	25.5	30.9
Unalloyed Welded or Seamless Pipes and Tubes, Threaded	258,045 stn	261,114 stn	157.3	179.9	14.4	68.2
Other Unalloyed Welded or Seamless Pipes and Tubes	269,188 stn	189,680 stn	101.7	68.6	-32.5	24.1
Unalloyed Pipes and Tubes of Circular Cross Section	173,439 stn	186,789 stn	90.4	103.8	14.8	49.8
Stainless and Alloy Tool Steel Pipes and Tubes	58,741 stn	90,855 stn	77.0	118.3	53.6	46.4
Nonferrous Metals			506.4	535.0	5.6	7.6
Copper and Copper Alloys			114.0	106.9	-6.2	9.3
Aluminum and Aluminum Alloys			331.1	347.5	5.0	17.4
Wrought Aluminum Sheets and Strip, Not Clad	142,521 stn	152,993 stn	302.9	313.8	3.6	51.4
Metal Containers			29.6	141.0	376.4	47.7
Wire Products (excl. insulated electric wire)			122.6	140.1	14.3	28.1
Nails and Industrial Fasteners			438.2	419.4	-4.3	39.5
Steel Nuts	61,801 stn	56,105 stn	90.9	88.8	-2.3	53.1
Steel Screws	181,519 stn	177,510 stn	209.1	200.5	-4.1	61.1
Industrial Chemicals (excl. fertilizers and pharmaceuticals)			1,047.2	1,098.1	4.9	16.2
Other Cyclic Organic Chemical Products			151.3	123.1	-18.6	16.7
Amino Acids and Other Nitrogenous Compounds			127.1	113.5	-10.7	17.5
Synthetic Organic Dyestuffs			103.1	117.2	13.7	35.4
Plastic Materials and Resins			310.1	321.4	3.6	22.9
Flexible Film, Strips and Sheets of Plastic Materials			125.0	135.1	8.1	26.0
Tires and Tubes (excl. car, truck and bus tires)			90.3	94.8	5.0	27.8
Paper Products			79.2	106.4	34.3	1.9
Yarns, Fabrics and Made-Up Textile Articles			671.0	715.2	6.6	14.6
Cotton Fabrics	79,031,384 syd	111,755,237 syd	111.0	142.6	28.5	17.0
Manmade-Fiber Fabrics	229,130,365 syd	217,790,778 syd	260.4	272.2	4.5	35.3
Fabrics 85 Percent or More By Weight Polyester	n.a.	134,181,919 syd	n.a.	135.9	n.a.	55.3
Photographic Film and Paper (excl. film for retail sale)			293.1	345.7	17.9	45.3
Silver Halide Color Photographic Paper	443,728,422 sft	686,697,071 sft	103.8	133.9	29.0	52.6
Food and Feed			443.9	500.3	12.7	2.3
Fish and Fish Products			244.6	278.1	13.7	7.0
Miscellaneous Imports			383.4	734.4	91.5	7.8

Key to quantity abbreviations: no = number pc = pieces sft = square feet stn = short tons syd = square yards

Source: Department of Commerce

Table 53: U.S. Direct Investment Position Abroad, Year-End 1981-1985*

(in millions of dollars)

	1981	1982	1983	1984	1985
Developed Countries	$167,439	$154,381	$155,736	$157,461	$172,750
Canada	47,073	43,511	44,339	46,830	46,435
United Kingdom	30,260	27,537	27,637	28,635	33,963
West Germany	15,840	15,463	15,319	14,794	16,746
Switzerland	12,509	12,863	14,099	14,865	16,230
Japan	6,755	6,407	7,661	7,920	9,095
Australia	8,757	9,089	9,005	8,674	8,564
France	9,132	7,391	6,614	6,224	7,835
Netherlands	8,813	6,760	6,613	6,201	7,064
Italy	5,275	4,316	4,461	4,592	5,644
Belgium	6,288	5,549	4,438	4,602	5,105
Developing Countries	56,163	48,058	45,746	50,131	54,474
Bermuda	10,445	11,519	11,056	13,009	14,104
Brazil	8,247	9,290	9,068	9,377	9,480
Mexico	6,977	5,019	4,381	4,568	5,087
Panama	3,784	4,413	4,837	4,467	4,611
Indonesia	1,847	2,295	2,770	3,987	4,087
International	4,747	5,314	5,721	5,402	5,443
Total	228,348	207,752	207,203	212,994	232,667
of which:					
Petroleum	53,244	57,817	57,574	59,089	58,347
Manufacturing	92,388	83,452	82,907	85,253	95,586
Wholesale Trade	28,332	20,788	21,278	21,790	23,822
Banking	8,513	10,317	12,387	13,246	14,728
Finance, Insurance and Real Estate	26,570	18,018	15,075	15,828	21,914
Services	19,301	4,615	4,670	4,625	5,260
Other		12,745	13,312	13,165	13,010

*Data for 1981 and the 1982-1985 period are not comparable since the 1981 figures are linked with the Commerce Department's 1977 benchmark survey and the 1982-1985 statistics with the 1982 benchmark survey.

Source: Department of Commerce

Table 54: U.S. Direct Investment Position in Japan, Year-End 1981-1985*

(in millions of dollars)

	1981	1982	1983	1984	1985
Total	$6,755	$6,407	$7,661	$7,920	$9,095
Petroleum	1,737	1,650	1,902	2,052	2,178
Manufacturing	3,236	3,058	3,915	3,942	4,621
Food Products	185	166	155	65	127
Chemicals	767	778	1,148	1,175	1,244
Metals	80	67	79	42	50
Nonelectric Machinery	1,185	1,103	1,270	1,245	1,620
Electric Machinery	228	243	312	374	337
Transport Equipment	300	380	480	477	578
Other	490	322	471	564	665
Trade	1,215	1,093	1,252	1,314	1,442
Banking	**	166	176	176	177
Finance, Insurance and Real Estate	221	312	325	347	519
Services	**	42	21	31	74
Other		85	69	58	83

*Data for 1981 and the 1982-1985 period are not comparable since the 1981 figures are linked with the Commerce Department's 1977 benchmark survey and the 1982-1985 statistics with the 1982 benchmark survey.

**Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

Table 55: Foreign Direct Investment Position in the United States, Year-End 1981-1985

(in millions of dollars)

	1981	1982	1983	1984	1985
United Kingdom	$18,585	$28,447	$32,152	$38,387	$43,766
Netherlands	26,824	26,191	29,182	33,728	36,124
Japan	7,697	9,677	11,336	16,044	19,116
Canada	12,116	11,708	11,434	15,286	16,678
West Germany	9,459	9,850	10,845	12,330	14,417
Switzerland	5,474	6,378	7,464	8,146	11,040
Netherlands Antilles	8,232	9,190	9,948	10,935	10,603
France	5,876	5,708	5,726	6,591	6,295
OPEC Countries	3,336	4,045	4,039	4,892	4,560
Total	108,714	124,677	137,061	164,583	182,951
of which:					
Mining	2,152	1,876	1,928	3,920	4,070
Petroleum	15,246	17,660	18,209	25,400	28,123
Manufacturing	40,533	44,065	47,665	51,802	60,798
Wholesale Trade	16,012	18,397	21,031	24,455	27,514
Retail Trade	4,525	5,207	5,482	6,764	6,698
Banking	6,553	7,846	8,697	10,326	11,503
Finance	1,109	2,159	2,269	5,633	4,708
Insurance	7,086	7,928	8,665	8,922	11,069
Real Estate	8,964	11,520	14,636	17,761	18,557
Other	6,533	8,019	8,478	9,599	9,912

Source: Department of Commerce

Table 56: Japan's Foreign Direct Investment Position in the United States, Year-End 1981-1985

(in millions of dollars)

	1981	1982	1983	1984	1985
Total	$7,697	$9,677	$11,336	$16,044	$19,116
Mining	4	4	*	7	7
Petroleum	-78	113	-408	-88	31
Manufacturing	1,321	1,624	1,605	2,460	2,621
Food Products	165	182	186	186	149
Chemicals	249	252	283	252	267
Metals	121	117	140	541	575
Machinery	415	423	466	628	624
Other	372	649	530	853	1,005
Wholesale Trade	4,984	6,126	7,823	9,689	11,572
Retail Trade	67	151	234	252	250
Banking	1,180	1,325	1,384	1,853	2,176
Finance	*	-570	*	513	710
Insurance	*	169	182	138	122
Real Estate	305	396	515	744	1,054
Other	350	339	430	475	575

*Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce